OVERSIGHT OF PRUDENTIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, AND ACCOUNTABILITY OF MEGABANKS AND OTHER DEPOSITORY INSTITUTIONS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

MAY 16, 2019

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OVERSIGHT OF PRUDENTIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, AND ACCOUNTABILITY OF MEGABANKS AND OTHER DEPOSITORY INSTITUTIONS

Thursday, May 16, 2019

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

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Velazquez, Sherman, Meeks, Clay, Scott, Green, Perlmutter, Himes, Foster, Beatty, Vargas, Gottheimer, Gonzalez of Texas, Lawson, San Nicolas, Tlaib, Porter, Axne, Casten, Pressley, McAdams, Ocasio-Cortez, Wexton, Lynch, Adams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Wagner, Lucas, Posey, Luetkemeyer, Huizenga, Duffy, Stivers, Barr, Tipton, Williams, Hill, Zeldin, Loudermilk, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Gooden, and Riggleman.

Chairwoman WATERS. The Financial Services Committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, and Accountability of Megabanks and Other Depository Institutions." I now recognize myself for 4 minutes to give an opening statement.

Today, this committee convenes for a hearing with our nation's prudential regulators. Last month, we held a hearing with the CEOs of seven of our nation's largest banks.

In March, we held a hearing specifically focused on Wells Fargo and its pattern of harming its customers. Now, we have with us today, the regulators responsible for overseeing those institutions, as well as other financial institutions.

For some time, I have voiced concerns that the fines levied by our regulators against megabanks that break the law ultimately just amount to the cost of doing business for these institutions and do not effectively lead them to change their behavior.

In the last 10 years, the U.S. Global Systemically Important Banks, that is the G-SIBs, have collectively paid at least $163.7 billion in fines for consumer abuses and other violations of the law. Over the same period, they made $780 billion in profits.

In the last decade, Wells Fargo alone paid more than $11 billion in fines, but has raked in over $197 billion in profits. That institution has been engaged in widespread consumer abuses, including the creation of millions of fraudulent, unauthorized accounts. While Wells Fargo remains under an asset cap imposed by the Federal Reserve, and has recently been publicly rebuked in statements by regulators, these steps do not appear to have gone far enough. Today, Chairman Quarles, Comptroller Otting, and Chairman McWilliams must describe what additional steps they are prepared to take to rein in abusive megabanks like Wells Fargo.

I am also very concerned that the Federal Reserve, the OCC, and the FDIC have proposed weakening capital stress-testing and other requirements for the largest financial institutions, and appear to be kowtowing to Trump's harmful deregulatory agenda, checking items off of the to-do list provided by Trump's Treasury Department in a series of reports they have released.

I want our witnesses to know that Congress is paying careful attention to your actions, and we will not tolerate actions that threaten the stability of our financial system.

Additionally, in the wake of the passage of S. 2155 last Congress, bank consolidation is accelerating, as I previously warned it would.

The proposed BB&T and SunTrust merger would create the sixth largest bank in the United States. But while thousands of banks have proposed to merge between 2006 and 2017, not a single bank merger application was formally rejected by the Federal Reserve.

Bank mergers should not simply be rubber-stamped by our regulators. They should provide a clear public benefit for the communities the banks serve.

That is why I have called for additional public hearings in States that would be affected by the proposed merger, as well as for regulators to defer a decision on the merger until this committee has an opportunity to thoroughly review the matter.

I look forward to discussing these and other matters with our witnesses today.

The Chair now recognizes the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 4 minutes for an opening statement.

Mr. MCHENRY. Thank you, Chairwoman Waters, for holding today's hearing. And I want to thank the regulators for being here.

Almost a decade ago, the Dodd-Frank Act resulted in more than 400 new regulations and nearly 28,000 new restrictions. That is more than the cumulative number of restrictions resulting from all other laws passed during the Obama Administration.

It was such a massive undertaking that the Federal financial regulators have yet to promulgate some of these rules 10 years post-crisis.

Dodd-Frank was sold as an answer to consumer protection and financial stability. But it has resulted in increased costs for financial institutions and more headaches and paperwork for Americans as they try to open a bank account, get a mortgage, or save for retirement.

One year ago, we enacted a bipartisan bill to balance the need for financial stability and consumer protection with regulatory right-sizing.

The passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act brought the proverbial pendulum back toward the center, offering targeted relief to put financial institutions back in the business of serving their customers and, by the way, the American economy.

Last week, I wrote to three of you on the panel about the faithful and swift implementation of this change in public law, notably the Volcker Rule, community bank capital simplification, tailoring for banks with more than $50 billion in assets and improvement to the supplemental leverage ratio for custody banks, among others.

These four alone have the potential to provide billions of dollars in banking services for institutions and retail customers. I urge you to swiftly and faithfully implement the contents of what we commonly call S. 2155.

Chairwoman Waters and I both agree that consolidation is being driven by regulation. And the failure to swiftly implement this new law will drive more consolidation and the closure of more community institutions if it is not done. That is why we have provided that right-sizing in relief for community banks and credit unions, as well.

The comment period is closed on these provisions, and it is critical that you work to implement this law without delay.

Aside from new congressional mandates, many of the rules in which you are currently supervising merit modernization. Take, for example, the Community Reinvestment Act (CRA). CRA was enacted the same year Apple was incorporated to sell one of its first personal computers.

Today, Americans conduct the overwhelming majority of their financial transactions by smartphone. Yet, the CRA hasn't seen even modest reform in more than a decade. That is problematic. And it no longer reflects the realities of a revolutionized banking sector. This needs to be updated. Better regulation can fix that.

Finally, it is vital that you prioritize innovation and financial technology. Fintech holds considerable promise for institutions and consumers alike and will play a significant role in compliance and risk management as well.

It is important to ensure that banks can have the sound legal footing to partner with technology companies. The bank fintech partnership holds considerable promise for institutions and consumers alike. But if bedrock legal principles such as valid-when-made and true lender are not resolved by the regulators, the next wave of digital banking will be for naught.

I look forward to your testimony and to the questions today.

Chairwoman WATERS. The Chair now recognizes the Chair of our Subcommittee on Consumer Protection and Financial Institutions, Mr. Meeks, for 1 minute.

Mr. MEEKS. Thank you, Chairwoman Waters, for calling this timely hearing. And I wish to briefly flag some issues I hope to engage on with the witnesses who are here today and going forward.

First, I am very concerned about CECL. My main concern is the real-world impact on small community banks, minority banks, and access to credit by the underbanked. I believe that we should seek to confirm and quantify the expected impact on these groups before

implementing an accounting rule that has material real-world consequences.

Second, minority banks are disappearing at an alarming rate. And following the financial crisis, black homeownership is down to pre-civil rights numbers. We absolutely need to do more to promote MDIs and support minority communities' access to affordable credit.

Third, I remain very concerned about leveraged lending.

And finally, I have been encouraged to hear the progress and collaboration across regulators on CRA modernization, and I intend to continue to monitor those issues.

I thank you, and I yield back.

Chairwoman WATERS. Thank you.

The Chair now recognizes the subcommittee's ranking member, Mr. Luetkemeyer, for 1 minute.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

The biggest news in the last few years has been our great economic progress. We have made unbelievable strides by overhauling our tax system, unleashing our economic potential, and fundamentally shifting towards a responsible regulatory environment. To get this momentum going, we need cooperation between Congress and Federal financial regulators, which is imperative.

Today, we have before us four regulators who are charged with overseeing our financial system and ensuring all Americans have the economic freedom to participate in our growing economy.

I would first urge all of you to implement the statutory changes included in S. 2155 without delay, specifically, tailoring for regional banks, community bank capital requirements, and supplemental leverage ratio for custody banks.

Additionally, financial institutions across this nation are facing the most significant accounting change in decades. I have expressed my strong concerns over the broad potential impacts of FASB's CECL standard and I urge delayed implementation until you all have thoroughly studied CECL and understand the consequences.

Together, we must work towards smarter streamlined regulatory regimes that promote not just transparency but also effective taxpayer and systemic protections.

I thank the panel for their willingness to work alongside Congress and for appearing before us today.

Thank you very much, and I yield back.

Chairwoman WATERS. Thank you.

I want to welcome today's distinguished panel: the Honorable Rodney Hood, Chairman, National Credit Union Administration; the Honorable Jelena McWilliams, Chairperson of the Federal Deposit Insurance Corporation; the Honorable Joseph Otting, Comptroller, Office of the Comptroller of the Currency; and the Honorable Randal Quarles, Vice Chair of Supervision, Board of Governors of the Federal Reserve System.

I want to extend a special welcome to Chairman Hood and Chairman McWilliams. Neither of you has testified before the committee, and we look forward to hearing from you.

It has been over 3 years since NCUA or FDIC has appeared before the committee, so your appearances are long overdue.

Without objection, all of your written statements will be made a part of the record.

And each of you will have 5 minutes to summarize your testimony. When you have 1 minute remaining, a yellow light will appear. At that time, I would ask you to wrap up your testimony so we can be respectful of both the witnesses' and the committee members' time.

Chairman Hood, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF THE HONORABLE RODNEY HOOD, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

Mr. HOOD. Good morning, Chairwoman Waters, Ranking Member McHenry, and members of the committee.

Thank you for the opportunity to testify today about the state of America's federally insured credit unions and the NCUA's efforts to maintain a safe and sound credit union system.

Federally insured credit unions are vital to the economic stability of communities across America. More than one-third of all U.S. households are members of credit unions.

In 2018, the credit union system continued to perform well. By year's end, credit union membership grew to more than 116 million members and assets increased to $1.45 trillion. The credit union system is well-capitalized, with an aggregate net ratio of 11.3 percent, well above the 7 percent statutory requirement.

The share insurance fund is strong, so strong, in fact, that we have been able to issue nearly $900 million in share insurance fund dividends over the last 2 years. Credit unions are using these funds to improve the financial capability of people of modest means, support small businesses, and strengthen communities across the country.

My priority is to strengthen the vitality of the credit union industry by doing even more to bolster underserved communities, including those in rural areas, persons with disabilities and low- to moderate-income households.

To that end, I am working closely with the agency's senior leadership, especially the Offices of Minority and Women Inclusion, and Credit Union Resources and Expansion to ensure that NCUA is doing everything we can to assist small and low-income-designated credit unions, including encouraging the formation of de novo minority depository institutions.

For example, we are helping credit unions navigate the certification process for becoming community development financial institutions. We are also providing grants to low-income-designated credit unions through our community development revolving loan fund.

Last year, NCUA awarded over $2 million in technical assistance and urgent-needs grants to 211 credit unions to help them develop new products and services, recover from natural disasters, and offer financial services to unbanked and underserved populations.

Just last month we entered into a partnership with the Small Business Administration (SBA) to help credit unions better utilize the SBA's various lending programs.

I further intend to leverage my expertise and experience as a former Rural Housing Administrator at the U.S. Department of Agriculture in order to seek additional opportunities to connect credit unions and their members in rural areas to existing public sector lending programs.

And next week, I have the honor of presenting a new Federal credit union charter that will serve a Native American community. This low-income-designated credit union will provide much-needed financial services to individuals and businesses in one of the nation's most underserved areas.

On the regulatory front, we are constantly evaluating our regulatory framework to ensure that our rules are effective, but not excessive.

For example, we are in the process of providing federally chartered credit unions more flexibility under our payday alternative loan program, allowing them to safely offer less expensive small-dollar loan options with a sound fidelity to consumer protection.

Wherever we have the authority to improve the regulatory system and create a safe environment for credit unions and their members, we are doing our level best to do so.

While the credit union system is strong, and the NCUA is faithfully executing its mission, I remain focused on the various risks posed by the rapidly changing financial services landscape.

Frankly, one of them, cybersecurity, keeps me up at night. Cyberattacks pose an enormous threat to the entire financial system, including credit unions. The credit union system is especially vulnerable to this risk because the NCUA lacks sufficient legal authority to directly identify and address systemic security risk within the system.

However, strengthening our cyber defense is one of the NCUA's top priorities. And we collaborate regularly with our peer regulators on how best to address the challenges.

As chairman, I intend to employ the resources necessary to combat cybersecurity threats and ensure data protection for the agency, the credit union industry, and its members.

I want to close by highlighting an area where congressional action would help credit unions better serve their members and communities, especially those of modest means.

Amending the Federal Credit Union Act to permit all types of federally chartered credit unions to add underserved areas to their fields of membership or promote financial inclusion and shared prosperity and underserved and distressed communities.

I look forward to working with members of this committee on these and other legislative issues.

Finally, I will just note that my written testimony today details the information requested in the invitation to appear before you. Thank you for the opportunity to testify today.

I look forward to your questions.

[The prepared statement of Chairman Hood can be found on page 74 of the appendix.]

Chairwoman WATERS. Thank you, Chairman Hood.

Chairman McWilliams, you are now recognized for 5 minutes to present your testimony.

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

Ms. MCWILLIAMS. Thank you. Good morning, Chairwoman Waters, Ranking Member McHenry, and members of the committee and staff.

Thank you for the opportunity to testify today about the FDIC's efforts to strengthen our oversight of depository institutions of all sizes and ensure that our regulated institutions are serving their communities.

The nation's banks are at the center of economic activity in their communities. And this is especially true of minority depository institutions and community banks. The ability of community banks to provide safe and secure financial products and services forms the backbone of a strong national economy.

For these reasons, the FDIC's oversight of banks is critical to financial stability and consumer protection. It is incumbent upon us to exercise our oversight judiciously and in a manner that recognizes each institution's unique business model and risk profile.

My written statement details the many actions the FDIC has taken over the past year, both independently and in cooperation with our regulatory partners, to ensure that we are appropriately addressing risks to the system and are not imposing unnecessary regulatory burdens that might impede safe and secure banking activities.

My written statement also contains an update on the progress we have made in implementing the Economic Growth, Regulatory Relief, and Consumer Protection Act.

In addition to our supervisory role, the FDIC is tasked with resolving failed banks, and if called upon, large bank-holding companies and other systemically important financial institutions.

The FDIC reviews bankruptcy planning requirements for the largest U.S. bank-holding companies and the resolution plans filed by larger insured depository institutions.

This work, along with other measures, has improved our readiness for these resolutions and helps ensure that market participants and not taxpayers bear the risks of loss in the event of a large bank failure.

Most of my professional and personal life has been focused on the financial services industry. Before my tenure at the FDIC, I intuitively understood how important our nation's banks were to the economy.

But until I had real conversations with bankers, their customers, the communities that they serve, and State supervisors on my 50-State listening tour, I did not fully appreciate how our banks, particularly community banks and minority depository institutions, are so intimately involved in the fabric of their communities' and customers' lives.

I am nearly halfway through my nationwide listening tour. Across the country, these banks help fund a town's grocery store, barber shop, restaurants, local libraries, and small businesses.

In rural communities, urban settings, and low- and moderate-income communities, our banks provide a critical lifeline for low- and moderate-income customers, while supplementing infrastructure

and social services. It is the FDIC that provides consumers with the confidence to trust these banks with their deposits.

And I would be remiss if I did not mention the 6,000 dedicated FDIC employees who go to work every day laser-focused on protecting the stability and integrity of our financial system. I am proud to stand with them as we fulfill our mission to preserve and promote public confidence in the U.S. financial system.

Thank you again for the opportunity to testify, and I welcome your questions.

Chairwoman WATERS. Thank you very much. And I did refer to you as "Chairman" McWilliams. I understand that is your preference. I don't want to hear from the public that I incorrectly addressed you. Is that correct?

Ms. MCWILLIAMS. Madam Chairwoman, any which way you call me is fine.

Chairwoman WATERS. All right. Thank you very much.

[The prepared statement of Chairman McWilliams can be found on page 107 of the appendix.]

Comptroller Otting, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF THE HONORABLE JOSEPH OTTING, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. OTTING. Thank you very much, Chairwoman Waters, Ranking Member McHenry, and members of the committee.

I am honored to be here today to share my perspective on the condition of our nation's banking system and efforts to ensure that banks serve their customers and promote economic opportunity for all, while still operating in a safe, sound, and fair manner.

The nation's banking system's financial performance improved in 2018 and early 2019, driven primarily by strong operating performance. Capital and liquidity remained near historic highs. Return on equity is near—

Chairwoman WATERS. Excuse me. Could you pull your microphone a little bit closer to you? Some of our Members are having a difficult time hearing you. Thank you.

Mr. OTTING. How is that? Is that better?

Chairwoman WATERS. Yes, thank you.

Mr. OTTING. Yes. I apologize. That increased 25 percent for banks with less than $1 billion in assets and nearly 50 percent for the Federal banking system as a whole. Asset quality, as measured by traditional metrics such as delinquencies, non-performing assets and losses, is strong and stable.

While the condition of the Federal banking system is strong, the OCC monitors risk to the system on a continuing basis and summarizes those risks in our semi-annual risk perspective. Key risks highlighted in the most recent report include credit, operational compliance, and interest rate risk.

These areas continue to evolve in the context of a changing economically, technological and banking operating environment. Examiners will be paying close attention to these risks in the supervisory strategies for the banks they supervise.

Maintaining the viability of the nation's economy depends, in part, on the ability of financial institutions, particularly community and mid-sized banks and savings associations, to operate efficiently, effectively, and without unnecessary regulatory burden.

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2019 provided a commonsense, bipartisan framework to reduce regulatory burden for small and mid-sized banks, while safeguarding the financial system and protecting consumers.

The Act exclusively tasks the OCC with implementing regulatory changes that afford Federal savings under $20 billion in assets greater business flexibility within the burden of changing charters. In 2018, the OCC issued a proposed rule to implement this law. We plan to issue a final rule in the near future.

In addition to this exclusive responsibility, the OCC is working with other regulators to implement additional commonsense reforms, which we believe will be completed by the third quarter of 2019, and all are scheduled before the end of the year.

In addition to the Economic Growth Act, the OCC has acted to promote economic opportunity and eliminate unnecessary burden by working to modernize the Community Reinvestment Act to increase investments in communities that need it most.

In addition, we are focused with the other agencies to make the banks' security compliance more efficient and effective, promote responsible short-term lending, and also support responsible innovation that provides more choices to consumers and businesses.

The OCC has been a leader and recognizes significant contributions our diverse workforce has made in our achieving our goal. Towards this end, we work to enhance diversity within every level of our agency and among the institutions we regulate. The OCC has had a diverse strategy for more than 10 years and regularly aligns its diversity goals with its strategic plan.

Our recruiting efforts include Hispanic-serving institutions, Historically Black Colleges and Universities, and outreach to minority student organizations to develop relationships and gain access to diverse applicant pools.

We offer paid intern programs to minority students at the college level. And for the first time in many years, we will be doing that at the high school level this year to provide exposure and opportunity in financial regulation and financial services.

I am also very proud to say the OCC has a number of employee network groups that promote diversity, including PRIDE, dedicated to the LGBT community, the Coalition of African American Regulatory Employees, the Hispanic Organization for Leadership and Advancement, the Women's Network, the Veterans' Employee Network, the Network of Asian-Pacific Americans, and Generational Crossroads, which fosters communication across generations in the workplace.

The OCC is equally committed to minority- and women-owned businesses at all levels of the agency's business activities. Payments to minority or women-owned businesses represented north of 43 percent of the OCC's contractor payments in 2018.

The OCC's actions to promote diversity amongst the banks it regulates includes regular technical assistance opportunities for minority depository institutions and convening a Minority Depository

Institutions Advisory Committee to advise the OCC on conditions of the MDIs and steps that support their viability.

Additionally, the OCC encourages MDI directors to attend agency workshops on governance, credit risk, compliance risk, and other important banking issues by waiving their participation fees.

My written testimony provides additional details on all of these topics.

Thank you for the opportunity to discuss these important issues, and I look forward to answering your questions.

[The prepared statement of Comptroller Otting can be found on page 132 of the appendix.]

Chairwoman WATERS. Thank you, Comptroller Otting.

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

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

Mr. QUARLES. Chairwoman Waters, Ranking Member McHenry, members of the committee, thank you for your time and for your invitation to testify today on the Federal Reserve's regulation and supervision of the financial system.

Our visit today comes 10 years, almost to the day, after the Federal Reserve released the results of its first supervisory stress test. That exercise was an invention of both urgency and necessity and a tool to move the country's largest financial institutions towards safety and stability.

Many innovations from that period are now regular elements of the Federal Reserve's supervisory and regulatory work. These innovations have helped strengthen firms that were damaged by the crisis. They have given supervisors and the public a clearer view of risks in the financial system. They have provided a solid foundation for the nation's economic recovery.

Now, when the financial system and economy are in good health, is the time to consolidate the insights we have gained with experience with these measures and to better the regulatory framework that we have built.

Today, I will briefly review the Federal Reserve's steps to improve this framework since my last appearance, outline the supervision and regulation report that accompanies my testimony, and discuss our other engagement on community, consumer, and financial stability issues, both at home and abroad.

Almost a year ago, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act. The cornerstone of this legislation was a directive to the regulatory agencies to tailor oversight of institutions to ensure that our regulations matched the character of the firms we regulate, with specific congressional direction for firms between $100 billion and $250 billion in total assets.

The core of the resulting regulatory efforts were the tailoring proposals for domestic institutions that the agencies issued last year. Those proposals share a common goal: To focus our energy and attention on both the institutions that pose the greatest risk

to financial stability, and the activities that are most likely to challenge safety and soundness.

A more recent proposal addresses prudential requirements for the U.S. operations of foreign banks. Like last year's tailoring proposal for domestic institutions, it categorizes firms according to their size, business model, and risk profile.

The proposal differs from the domestic proposals to account for the unique structural differences of foreign banks and asks for input on a number of important issues. I look forward to reviewing the comments we receive.

We also have been providing targeted regulatory relief, especially for community banks and other less complex organizations. The community bank leverage ratio would give community banking organizations a more straightforward approach to satisfying their capital requirements, for example.

We also propose to expand community banking organizations' eligibility for both longer examination cycles and exemptions from holding company capital requirements.

The report accompanying my testimony provides more details on these and other recent regulatory steps, as well as on the overall condition of the banking system.

In the past half year, the Board also took steps to consolidate the role that stress-testing plays in our work. Following the directive from S. 2155, we began to transition less complex firms to an extended testing cycle reflecting the lower risks they pose relative to their larger and more complex peers.

We published new details of our methodology and models, improving public understanding of the program and maintaining the integrity of its results.

We announced the new stress-testing conference that will take place in July to receive additional input on our practices. And while maintaining a rigorous evaluation of capital planning, we committed to addressing qualitative deficiencies at most firms through supervisory ratings and enforcement actions, rather than through a standalone qualitative objection.

As detailed in my written testimony, we have taken other steps that support our supervisory and regulatory framework by making it simpler and more transparent.

We also continue to engage with our regulatory counterparts overseas through standard-setting bodies and the Financial Stability Board, where I recently began a 3-year term as Chair.

The strength of our financial system today rests on the insight, patience, and persistence of a decade's work on post-crisis reforms. Only by thoughtfully evaluating the reforms we have made and adjusting our approach when appropriate can we preserve and improve the efficacy and efficiency of our regulatory framework.

Thank you. I look forward to answering your questions.

[The prepared statement of Vice Chairman Quarles can be found on page 157 of the appendix.]

Chairwoman WATERS. I now recognize myself for 5 minutes for questions. Over the last decade, bank merger applications have been approved at record speed and with little opposition from regulators.

According to the Federal Reserve, the median time it takes to approve a bank merger receiving opposition from community groups dropped to less than 4 months in the first half of 2018. And that compares to 7 months for all of 2015.

From 2006 through 2007, over 3,300 merger applications were approved by the Federal Reserve and the agency did not formally reject any merger application they received.

Regarding the proposed BB&T-SunTrust merger I received letters yesterday from the Federal Reserve and the FDIC that were non-responsive to my recommendation that additional public hearings in other States be held beyond the two hearings previously held.

Yesterday, I also learned from the CEOs of BB&T and SunTrust that the banks held six additional listening sessions in other States, though it is unclear how public those meetings were.

Vice Chairman Quarles and Chairman McWilliams, given the banks themselves have done additional listening sessions, what is the harm in your agency scheduling additional public hearings in other States that will be affected to ensure your agencies receive as much feedback as possible about the benefits and drawbacks before deciding on this proposed merger?

Vice Chairman Quarles?

Mr. QUARLES. Thank you. We have had an active process of seeking public input. In addition to the two public hearings in the two key areas where the banks operate, we have received 801 public comments on the merger. There is really no shortage of public input and we are in the process of evaluating that.

Chairwoman WATERS. In talking with the CEOs, they said they have no problem with having additional hearings. If they have no problem, why are you hesitant to have more public hearings?

Mr. QUARLES. As we look at approving any merger, including this merger, we are mindful that we do have a congressional framework that establishes what it is that we look at and the timeframes in which we are to look at them.

We are trying to balance, and I think we are doing a good job of balancing the need for public input, particularly on a merger of consequence like this. And we have gotten a lot of public input, with the congressional mandate to act in timeframes and with the considerations that we were directed to use.

Chairwoman WATERS. I have been around for quite some time and I can recall the days when we had many public hearings on proposed mergers. And I want to just continue with asking Chairman McWilliams, do you have any problem with having additional hearings?

Ms. MCWILLIAMS. We have held two hearings at which we have received a sizeable number of comments. And frankly, I pulled the numbers: We have heard from groups and individuals from 24 different States and the District of Columbia, and heard from individuals from 14 different States and Washington, D.C., at those two public hearings.

We have covered the majority of the markets that both BB&T and SunTrust serve at those hearings with representatives. It is my understanding from being briefed by my staff on how the hearings went and what was said at those hearings that over 90 per-

cent of the groups speaking at those hearings were speaking positively of the merger.

What we heard at those hearings and what we are looking at throughout the process do not seem to imply that we need to do more hearings.

Chairwoman WATERS. So, how many States are we talking about this merger impacting? How many States do they have banks in?

Ms. MCWILLIAMS. The hearings were held in the two home States—

Chairwoman WATERS. I know. Only two of how many?

Ms. MCWILLIAMS. Well, I don't know exactly what they are. We can get you the numbers on the footprint for both banks but representatives—

Chairwoman WATERS. I am trying to—

Ms. MCWILLIAMS. —from 24 different States from—

Chairwoman WATERS. —make the point that while there were two hearings, you have any number of other States that are impacted by this merger. How many other States, if the staff can give me that number?

Ms. MCWILLIAMS. I have the numbers. Individuals from 12 of the 16 markets that BB&T serves appeared at a hearing, and individuals from 9 out of 11 markets served by SunTrust.

Chairwoman WATERS. And so, I am questioning why you don't have more hearings? This is an important merger. This will be, I suppose, the sixth largest bank in this country.

We are concerned about consolidation, and we are concerned about making sure that the public is involved in understanding what is happening. And so, I am going to insist on asking you again in a formal way by way of a letter about consideration for additional hearings.

Twelve States, all right. Thank you very much. I will now yield to the gentleman from North Carolina, Ranking Member McHenry, for 5 minutes.

Mr. MCHENRY. Thank you.

Vice Chairman Quarles, Comptroller Otting, and Chairwoman McWilliams, thank you all for your interagency response to my letter. I have never seen such a timely interagency response, and I am grateful for that.

I appreciate the clarity you gave me on the questions I outlined. As a matter of congressional oversight of the implementation of public laws, that ongoing process is the insurance that we will have faithful implementation of our laws in a way that conforms with congressional intent.

And you outlined in your responses that there are a number of comment periods that have closed. But also, there is a significant amount of work to be done on your part and your staff. What I have heard around town is there are bandwidth issues which is, we don't have the capacity to get these things done.

It is a lot of work, then I look back at the Obama Administration. I never heard complaints about bandwidth issues, and there were a lot more regulations to implement then. And so, I just want to ask you: Do you currently have within your capacity, the staff, the necessary ingredients to get these rules enacted in a timely fashion?

Vice Chairman Quarles, I will ask you and Mr. Otting and Ms. McWilliams.

Mr. QUARLES. Yes. Yes, we do. As I think we indicated in response to our letter, the bulk of the the core proposal which came out last October was, and we don't keep the detailed records of this, but I feel quite confident in saying that that was the fastest proposal of an implementing regulation of a major congressional action in the history of the Federal Reserve, certainly, in the modern history of the Federal Reserve.

Mr. MCHENRY. We had 10 years to prepare, so that helps.

Mr. QUARLES. And we are on track to complete the implementing actions for S. 2155; we had the bulk of the implementing actions completed by the third quarter of this year and all of them completed by the end of this year.

Mr. MCHENRY. Thank you.

Mr. Otting?

Mr. OTTING. I think there has been a tremendous amount of communication. We also divided the rules. The common process is that one of the agencies will take a lead on a particular rule, so we have divided these rules.

So-called having the pen. What has worked effectively is the three of us speak almost every week and any items that are outstanding on S. 2155, we bring them right to the top.

All of us probably carry in our briefcase the matrix of where we are. So, we are acutely aware of the necessity to move those rules through the process. And I actually think we have had good cooperation and have had no bandwidth issues as we have tried to move both this and some other legislation forward.

Ms. MCWILLIAMS. The FDIC has highly capable staff who will complete the rulemakings in due time, and we work very well with our partner agencies.

Mr. MCHENRY. That is good. So to you, Ms. McWilliams and Mr. Otting, there is the ongoing question in the *Madden* v. *Midland* case of the question of valid when made. And my question to both of you is will you commit to providing clarity to banks and nonbank third parties as it relates to the foundational legal principle valid when made? Mr. Otting?

Mr. OTTING. Well, first of all, we do think that that was an inaccurate conclusion in that case. We had hoped for perhaps some legislative fixes to that, but it does appear now we will have to have some regulatory fixes to that, and we have begun the discussions within the agency.

Ms. MCWILLIAMS. The issue of Federal versus State law in banking cases is not new. What is new is that it comes at a time of great innovation that could stifle entrepreneurship and progress in how banks are able to conduct business. We are currently examining at the FDIC the appropriate role of the agency as this case unfolds.

Mr. MCHENRY. Well, time is ticking, and I will follow up with both of you on that.

Ms. MCWILLIAMS. I understand.

Mr. MCHENRY. Mr. Quarles, I will have a number of questions for the record about this switch from LIBOR to SOFR. The concern

here is the disruption in the marketplace. Is that a concern you share in the shift from LIBOR to this new benchmark standard?

Mr. QUARLES. It is. That is the reason that we began catalyzing the private sector response to this really beginning 7 years ago. The Federal Reserve was indicating that this needed to be done. I think as people think about the LIBOR transition question, it is important to remember that this is not a result of regulatory action.

We are not mandating the transition from LIBOR. We are recognizing that private sector banks that are responsible for determining LIBOR will no longer do so certainly, very well, may no longer do so after a period.

Mr. MCHENRY. I will submit more questions for the record on LIBOR versus SOFR.

Chairwoman WATERS. Thank you.

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

Ms. VELAZQUEZ. Thank you. Thank you, Madam Chairwoman. Comptroller Otting, last month I questioned Citigroup CEO Michael Corbat on his $24 million compensation package for 2018.

This outstanding package means the Citigroup CEO makes $486 for every dollar that the median employee at the firm is paid. When I asked him if he thought this ratio was fair, he responded by saying that his compensation is set by the board and voted on by shareholders.

Section 956 of the Dodd-Frank Act was created to prohibit excessive compensation packages in the financial industry that encourage inappropriate risk-taking.

However, a rule has never been finalized. Last month, you stated that the OCC was planning to take the lead and propose a rule on executive bonuses for bankers. What steps is the OCC currently taking to move forward with this rule?

Mr. OTTING. I am actually pleased to make some comments on this because I know it has been a very topical issue. If you may recall in 2011, there was a notice of proposed rulemaking that was introduced that stalled, and then in 2016—

Ms. VELAZQUEZ. Yes, I know that history but my time is limited.

Mr. OTTING. There was a detail to that history. I would say where we are right now is we are doing in a succession of this. Right now the OCC has put a draft together. We have shared it with the SEC. We have met with them.

The next plan once the two of us sign off is to engage the other four regulators and we are hopeful that this year we can introduce a notice of proposaed rulemaking.

Ms. VELAZQUEZ. Can you share with us regarding that draft if it contains any specific restrictions? We need a rule that contains actionable requirements.

Mr. OTTING. There are provisions in Dodd-Frank, and we intend to fully include all of the provisions in Dodd-Frank as required.

Ms. VELAZQUEZ. So it is going to be strong enough?

Mr. OTTING. I can't comment on specifics of the rules until I get feedback from the other agencies. This is a six-agency process, as you probably recall, and it is our intent to try to get this cleared

with the principles based of the rule incorporated into the document.

Ms. VELAZQUEZ. So we hope that he has and it contains strong requirements because if we see what happened recently with Wells Fargo, if you don't come out with a strong rule, then you are failing the American people. You are failing the thousands of families who lost their homes.

Comptroller Otting, your desire to update and modernize the Community Reinvestment Act has been well-publicized. You have stated that a proposed rule could be released by December. Do you still believe this is a realistic timeframe?

Mr. OTTING. As you know, this is a very complicated rule, with a lot of public input. I think we have 2,500 comments from meetings and public input. We are in the stages, right now, of discussion with the Federal Reserve and the FDIC and ourselves. I am hopeful of that, but—

Ms. VELAZQUEZ. Okay.

Mr. OTTING. This is a highly complex regulation that hasn't been looked at since 1977. Clearly, we want to be able to measure what gets measured, where it gets measured, how it gets measured, and more importantly, what is the aggregation in the industry that gets done on an annual basis.

Ms. VELAZQUEZ. Sir, do you believe that this proposal will be a joint proposal?

Mr. OTTING. I do.

Ms. VELAZQUEZ. Mr. Quarles, what is your opinion on that?

Mr. QUARLES. Yes, I agree the—

Ms. VELAZQUEZ. It is going to be a joint proposal?

Mr. QUARLES. The agencies are working well together. I expect it to be a joint proposal.

Ms. VELAZQUEZ. Chair McWilliams, how would you respond to what Comptroller Otting and Chairman Quarles just said?

Ms. MCWILLIAMS. I am in agreement that this should be a joint rulemaking, and we are working very hard. We are meeting every week at the principal level to discuss the issues and make sure the agencies are aligned. It is always good to have a joint rulemaking for matters that are this important to the communities, and we hope to proceed—

Ms. VELAZQUEZ. Are there any stumbling blocks that remain, from your perspective?

Ms. MCWILLIAMS. As a former regulatory attorney of the Federal Reserve who used to draft regulations, I can tell you once you start working on the nuances of each line, that is where you kind of jump into some of the difficult issues, but so far we are aligned.

Ms. VELAZQUEZ. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Missouri, Ms. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman.

On May 24, 2018, almost a year ago, President Trump signed into law what we have been speaking about as S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act. These reforms will improve economic growth and competitiveness

for financial institutions and their customers, and I am eager, as are many of my constituents, for them to move forward.

I am going to ask each of you for a very fast, lightning round update on the implementation of proposed rulemakings from S. 2155 that have a closed comment period. There are approximately eight of them. I am glad you have that matrix, Comptroller Otting. Here we go.

Number one, Section 214, promoting construction and development on Main Street, Mr. Quarles, Mr. Otting, Ms. McWilliams?

Mr. OTTING. Congresswoman Wagner, you are asking us when do we think that would get commenced?

Mrs. WAGNER. Yes. I want the status, the update. What is the status currently?

Mr. OTTING. I would say 60 days.

Mrs. WAGNER. Mr. Quarles, Ms. McWilliams, yes?

Ms. MCWILLIAMS. Sounds correct, yes.

Mr. QUARLES. Yes.

Mrs. WAGNER. Okay. Next, number two, Section 401, enhanced supervision and prudential standards for certain bank holding companies, Mr. Quarles?

Mr. QUARLES. Anything on which the comment period is closed, I think we will have a final rule on within 60 to 90 days.

Mrs. WAGNER. Within 60 days, 90 days?

Mr. QUARLES. Sixty to 90, yes.

Mrs. WAGNER. Sixty to 90. Section 201, capital simplification for qualifying community banks, Mr. Quarles, Mr. Otting, Ms. McWilliams, 60 days, 90, 30, 10?

Mr. OTTING. Sixty.

Mrs. WAGNER. Going with 60. Number four, Section 203, Community Bank Relief Act, Mr. Quarles, Mr. Otting, Ms. McWilliams?

Mr. OTTING. Final rule expected August 2019.

Mrs. WAGNER. August 2019. All right, good. Number five, Section 103, the rural area appraisal exemption, Mr. Quarles, Mr. Otting, Ms. McWilliams?

Mr. QUARLES. 60 to 90 days.

Mrs. WAGNER. Oh, come on. I need better than that.

Mr. Otting?

Mr. OTTING. I am trying to find it in my chart.

Mrs. WAGNER. I love your matrix. Can I just get a copy of your matrix, sir, no.

Mr. OTTING. Pardon me?

Mrs. WAGNER. No, sorry, I am teasing.

Mr. OTTING. As I said in my opening statement, almost all of these will be done by September 30th. A couple are going to move into the fourth quarter, but all are expected to be—

Mrs. WAGNER. Which ones will move into the fourth quarter do you think?

Mr. OTTING. Pardon me, ma'am?

Mrs. WAGNER. Which ones will move into the fourth quarter do you think? Look at the staff working behind you. This is great. Team effort. So as not to waste time, Section 103, rule area appraisal exemption.

Mr. OTTING. I don't know why I don't have that.

Mrs. WAGNER. Mr. Quarles, Mr. Otting?

Mr. OTTING. Final rule expected by July 2019.

Mrs. WAGNER. All right. Section 204—

Mr. OTTING. We would be more than happy to provide all of these dates to you.

Mrs. WAGNER. That is outstanding. I thank you very, very much and I will then—

Mr. OTTING. Mr. McHenry could provide you a copy of our letter.

Mrs. WAGNER. That would be just dandy. Thank you very, very much. It is very important that we get these done, especially those that have closed the comment period and move forward with this tremendous piece of bipartisan legislation.

Let me ask another question here. Pursuant to the Dodd-Frank Act, you promulgated the Volcker Rule in 2013, a highly complex and burdensome regulation restricting banks in engaging in proprietary trading or investing in covered funds despite the fact that propitiating in commercial banks was not central to the economic crisis.

Last year, you proposed amendments to the rule to address some of the burdens. And finally, last May, as part of Senate 2155, Congress acted to alleviate some of the harmful aspects of the Volcker Rule. Where do things stand on comprehensive Volcker Rule reform as well as with regard to implementing the provisions in S.2155?

Mr. QUARLES. I can address that. We have received hundreds of comments on the Volcker Rule proposal as both the Volcker Rule itself and the comments are extremely complex. The relevant agencies, there are five affected agencies, together have been reviewing those comments.

Our expectation is that we will have responses to those comments and a conclusion as to how to respond to them soon, I would say within the next couple of months.

Over the course of the summer, certainly, we will have that response. Necessarily because on the covered funds issues, as you know, in the proposal last year we asked questions as opposed to having a specific proposal on covered funds, there will be at least an initial proposal on what to do on covered funds and therefore an additional comment period with some process on that afterwards

Mrs. WAGNER. Thank you. My time has expired.

I yield back.

Chairwoman WATERS. The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. It has been a pleasure to sit next to my colleague, Mr. Meeks, for the last 20 years, and I join him with concern about CECL but I think it is up to us to solve the problem, although I would like you folks to respond for the record as to what we can do to solve it. As Mr. Meeks points out, it will be bad in its effect.

I am here to tell you it is bad accounting theory and the process that the FASB took to get this far is less democratic, less open, and less transparent than any other government agency I am aware of, although they will tell you it is better than the way they did other things.

So it is up to this committee to step in and get the FASB to delay, and if they don't, to actually pass legislation withdrawing this CECL regulation.

Mr. Hood, I couldn't agree with you more that credit unions need to be allowed and, in fact, encouraged to serve the underserved. And of course all regulators should be not only allowing but encouraging their institutions to do just that.

I have another question for the record but I would like you all to respond for the record and that is, what can you do so that we can make small business loans beyond those guaranteed by the SBA?

Because I remember when Jamie Dimon was here and he said, "We couldn't find any U.S. businesses, small and medium-sized business to make loans to. We had this capital so we sent it to London where it was eaten by the whale." You remember the whale.

So the fact is nobody is making a prime plus five loan. They say it is your fault. It could be quite reasonable for a bank to make some of those loans because there are businesses that have a significant risk but are the small business that will eventually be very important to our economy.

LIBOR is an index used in $400 trillion worth of instruments that are out there—$400 trillion here, $400 trillion there, it eventually adds up to real money. Of those, only about $2 trillion are what I call legacy LIBOR.

That is to say, they are going to be outstanding after 2021 when the LIBOR index is no longer published, but they reference LIBOR and they don't have a provision in there to say what is the backup reference.

And I wonder if you could work together to give us proposed legislation to say, okay, this is a matter of contractual interpretation. We will simply mandate that for the $2 trillion of legacy LIBOR, this is how you do the math. And I hope that you would respond to the record for that.

About 10 years ago, we had TARP. Mr. Quarles, I think you probably regulate the biggest of the big, can you guarantee us that no one institution will be able to call the White House or Congress and say, "We are going down and when we go down we will bring down a chunk of the economy with us"? They did that 10 years ago.

Can we just hang up on them now if they make that call? And don't tell me it is unlikely to happen because, trust me, your predecessor's predecessor told us in 2007 it wasn't going to happen. Go ahead.

Mr. QUARLES. Yes. There have been substantial improvements in the resolvability of all of the large institutions.

Mr. SHERMAN. So can you guarantee that if they call, we can hang up the phone? You are not going to be here saying, "Oops, you better pass TARP II"?

Mr. QUARLES. What I can guarantee is that the changes that have been made will give policymakers, including the Congress, more options than existed 10 years ago which could end up being—

Mr. SHERMAN. For those of us who lived through it, that is not a whole lot of comfort. What I tell you we can guarantee that if we break up the too-big-to-fail institutions and I am still looking for co-sponsors, particularly bipartisan co-sponsors, on that effort.

Let us see, let me go back to Mr. Hood. I believe that the nominal operating level for your reserve fund is 1.3 percent, but as a

result of recent changes, you are now up to 1.38 percent. Is it your intention to go back down to 1.3 percent?

Mr. HOOD. Yes, sir. I am looking at this with agency leadership and staff. In the month that I have been at the NCUA, I have had two briefings on the matter. I am pleased to report that we have been able to issue over $900 million in dividends through back to the credit unions. So we are continuing to assess and address operating levels.

Mr. SHERMAN. Thank you.

Chairwoman WATERS. The gentleman from Oklahoma, Mr. Lucas, is now recognized for 5 minutes.

Mr. LUCAS. Thank you, Madam Chairwoman.

And panel, I would like to turn to an issue that I think is close enough at hand and something you can do something about in short order. I have raised the issue of inter-affiliate margins several times to each of you. By now I think you all know the reasons why regulators should clarify the treatment of inter-affiliate transactions when it comes to initial margin.

Just to reiterate, you are the only G20 regulators who still require initial margin for these transactions. I also know you have heard from my colleagues both on this committee and in the Senate about this issue. So I will not belabor the point.

Chair McWilliams, can you update us on the progress in harmonizing your rules with the CFTC, as Treasury recommended to you in 2017?

Ms. MCWILLIAMS. Thank you for that question. On the interagency level we are working together to update the rule and we expect to seek comment in the near future on how to proceed.

There are several ways to proceed. One would be an interagency rulemaking. One of the other regulators has sole authority to act as well. So it is a question of how exactly we are going to proceed, but we are committed to proceed in the near future.

Mr. LUCAS. I will ask Chairman Quarles and Comptroller Otting, can you offer any thoughts or updates on this situation?

Mr. QUARLES. Yes. So the inter-affiliate margin question should be considered in the context of the existing provisions of the Federal Reserve Act and Federal Reserve regulations that provide protections to affiliates at transactions between depository instructions and their affiliates, 23A and 23B and Reg. W. And I think that existing framework should give us comfort as we look at removing the potential redundancies in the inter-affiliate margin rules.

Mr. LUCAS. I am pleased to hear that we are making progress on some of this or at least some movement. It has been a long time coming and will lead to a healthier derivates markets for everyone.

That said, I believe the time for change is now, quicker being more important than later. And I have been discussing this issue for almost 5 years and I would charge you to continue the forward momentum that we have right now.

Now, I understand there is some discussion of adopting this rule in a larger notice and comment review of the margin rules or prudential regulations. I fear however warranted these broader efforts may be, incorporating a fix in an inter-affiliate margin will only delay a badly needed police change.

Instead, I encourage you to address this issue through a discrete—yes, sometimes in Congress we advocate discrete actions—change in the margin rules that can advance independent of a larger undertaking. You have made such changes before these rules so please let us do that again here. Let us make this happen and bring us into balance of the rest of the G20.

Now that said, I sent a letter yesterday to the Fed, the FDIC, and the OCC on the SCRA proposal. Specifically, I am worried that the higher capital charges under SCRA will cause banks to pass those costs on to end users engaged in OTC transactions.

As a member of both the Agriculture Committee and this committee during the Dodd-Frank process, I can tell you that we did not intend for legitimate hedging by end users in the derivates markets to be penalized in this way. End users should have access to these markets to engage in prudent risk management practices.

Vice Chairman Quarles, we have discussed this in person. Have you heard these same comments from end users, and if so do you intend to address them in the final rule?

Mr. QUARLES. I have heard those comments from end users, and I am meeting with a coalition of end users again in a few days where I expect to hear additional details on them. And we are giving that careful consideration as we consider how to respond to comments on our proposal.

Mr. LUCAS. I am proud that the constituents are making it clear to both you and I. Another SCRA question for you all is related to an offset for client margin and supplemental leverage ratio.

In February all of the CFTC Commissioners, Democrat and Republican, sent a comment letter to the Fed, the FDIC, and the OCC raising concerns about the SLR. Specifically, not offsetting client margin has had bad effects on the derivatives market for end users seeking to hedge risk. Are each of you aware of the CFTC comment letter and have any of you discussed it further with the CFTC?

Mr. QUARLES. Yes and yes. All of us, we work quite closely with Chris Giancarlo on these issues on how bank regulation affects trading in the derivates markets.

Mr. LUCAS. My final comment simply is I would encourage you to heed the CFTC's advice before publishing a final rule. They all agree on this regardless of partisan affiliation and directly oversee those markets.

I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

The gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is recognized for 5 minutes.

Mr. MEEKS. Thank you, Chairwoman Waters.

First, I have two letters, one from the National Bankers Association and the other from the Abacus Bank in New York, and I would like to submit those letters for the record.

Madam Chairwoman, I would like to submit these two letters for the record.

Chairwoman WATERS. Without objection, it is so ordered.

Mr. MEEKS. Let me start with Chairman McWilliams. These are two small MDIs, one is a small MDI bank serving underbanked Chinese communities and these MDIs expressed their concern that

CECL implementation may increase the cost and availability of loans to their core clients, mainly minority communities of low- and moderate-income.

So my question to you is, do you believe that there is any credence to these concerns and can we confidently dismiss this risk without conducting a quantitative study?

Ms. MCWILLIAMS. Thank you for that question. I have made it a point to go to different States and meet with bankers and I have to tell you, the first question that comes out in these meetings from community bankers, including MDIs, is CECL and their concerns about implementing it.

As you know, that rule is promulgated by FASB. So long as U.S. banks have to follow U.S. GAAP, which is a statutory requirement, and FASB is in charge of U.S. GAAP measures, our hands are somewhat tied. I do believe that banks are faced with uncertainty about how to implement it.

There are many different ways of implementing it. The FDIC has held workshops to help banks navigate this process without having to hire outside consultants and pay a lot for the implementation systems.

We will do whatever we can to ease the implementation burden on the banks but the rulemaking itself, including the studies et cetera, is outside of our review. It will have to be done by FASB.

Mr. MEEKS. I have tremendous concerns because there is a rapid disappearance of MDIs, and that is a major concern of mine also. And your organization generally tracks this also, I believe.

So what are you doing to increase the number of de novo MDIs, to support and provide technical assistance to existing MDIs, and importantly, to prioritize MDIs in acquiring branches or operations for many of the failing banks?

Ms. MCWILLIAMS. I have made minority depository institutions a priority since I came to the FDIC last June. We now have a dedicated coordinator for MDIs across the country. We have done a lot of additional technical assistance.

I have also increased their membership on our Community Bank Advisory Committee from one MDI to three, so now one-sixth of the Committee is MDIs. I have met with a number of MDIs throughout the country, including in States like California, Georgia, et cetera.

We are also holding roundtables. We have a roundtable with 110 MDI CEOs scheduled for June of this year where we will allow them to engage with each other on exchanging best practices as well as providing technical assistance and workshops. The workshops will focus as well on how to train MDIs to prepare a successful bid for some of these branches and mergers and acquisition of other banks.

Mr. MEEKS. Thank you. I would like to follow up with you at some other time. My time is limited here—

Ms. MCWILLIAMS. Thank you.

Mr. MEEKS. —but I would love to follow up because that is a tremendous concern of mine also.

Ms. MCWILLIAMS. It is of mine as well. Thank you for that.

Mr. MEEKS. Let me go to Mr. Quarles really quick, the general argument right now is that leveraged lending may be a recession amplifier but does not pose a systemic risk, in part because only

12 percent is held in the banking system and much of it is held by patient capital.

But isn't there a model correlation risk, specifically asset quality or concentration rules, that may force CLO's funds into synchronous sell off of these debts than of a general credit downgrade of the underlying assets?

Mr. QUARLES. Our analysis of the CLO holding structure is that there is not a risk of sort of a financially destabilizing run from those institutions, even if there were a significant repricing of the leveraged loan assets that the CLOs hold.

Mr. MEEKS. Even if the economy was softening?

Mr. QUARLES. Yes, even if the economy were softening. But as you said at the outset, a separate and important question is that a repricing of those assets could have a magnifying effect on a business downturn.

We don't think that would turn into a financial stability problem, but if these assets were to reprice substantially, given the increase in volume there has been of them, the investors in them would lose money, clearly. And that could exacerbate a business downturn.

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

Chairwoman WATERS. Thank you.

The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Thank you all for being here today, and you certainly have brought a breath of fresh air from the standpoint of your positions, from the standpoint of having some real-world experience besides being a bureaucrat. So now you are bringing some of that expertise in and we appreciate that.

Mr. Hood, my first question is for you. I am very concerned about CECL. I have requested from numerous associations and entities with regards to the effect on it. And two of your credit union associations, NAFCU and CUNA, have given me some information here. And let me just read from their studies.

NAFCU says that almost everyone's capital is going to be negatively impacted in some way. There is going to be a rise in the cost of credit to consumers. There is going to be constraint in the amount of the credit available.

The credit unions are going to be making fewer loans to members, primarily in the mortgage and personal loan space, and the real kicker to the whole thing here is there is a chart on the back that shows there is going to be a $30 billion hit to the capital accounts of the members of this association. That is significant.

CUNA did a study. Their numbers came back completely eliminates specific loan offerings or to reduce the CECL impact, 15 percent likely will do that. To tighten credit standards to offset or reduce CECL's impact, 31 percent, and increased loan rates or increased loan fees to offset or reduce CECL's financial impact, 35 percent. Would you like to comment on that?

Mr. HOOD. I share the concerns that have been raised by the industry groups you have cited. We, as an industry, or we, as an agency, are also doing our own internal studies with our chief economist. I find the operational burdens that are going to be imposed

by CECL to be really difficult for a lot of our smaller credit unions to manage and operate in that environment.

We, though, will need more assistance from FASB to address some of these issues. I do have a little bit of comfort in that a lot of our institutions, whether they be credit unions or community banks, will be exempted from doing a lot of the complex formal forecasting that is required.

Mr. LUETKEMEYER. This will affect their customers, will it not? In fact, when you start talking about raising costs—

Mr. HOOD. It could have a deleterious impact on our ability—

Mr. LUETKEMEYER. —and restricting credit?

Mr. HOOD. Yes, sir. It could have a deleterious impact on—

Mr. LUETKEMEYER. We had the Home Builders in here twice already and they made a comment that for every $1,000 increase in the cost of a home loan, 100,000 people across the country will no longer have access to funds. That is a devastating number.

Mr. Quarles and Mr. Otting and Ms. McWilliams and Mr. Hood, one quick question here for each one of you. FASB admits they did not study this. They did not do a cost-benefit analysis. They didn't study the economic impact across the country or on consumers.

This is a huge rule that they are proposing, similar to what they did with mark-to-market, and look at the disastrous result of exacerbating the downturn, in my mind, is what happened on mark-to-market, before they had to pull it.

Would you, Mr. Quarles, Mr. Otting, Ms. McWilliams, and Mr. Hood, would your agencies go out and make a rule of that nature and not study it and not have a cost-benefit analysis on it?

Mr. Quarles?

Mr. QUARLES. We are required, and I think it is good practice, to have a good cost-benefit analysis of any rules that are propose.

Mr. LUETKEMEYER. Mr. Otting, would your agency do that?

Mr. OTTING. We would not.

Mr. LUETKEMEYER. Ms. McWilliams?

Ms. MCWILLIAMS. It is always good practice to provide and conduct analysis before you finalize a rule.

Mr. LUETKEMEYER. Mr. Hood?

Mr. HOOD. We would also agree. We will conduct an analysis and use our chief economist to come up with a cost-benefit analysis.

Mr. LUETKEMEYER. So wouldn't it be great if all of you would ask them to pause on this and do a study to see that impact, because it is going to have dramatic impact on all of the entities that you regulate?

Mr. HOOD. Yes, sir. I would be willing to work with them on that accord, especially because of credit being managed to underserved communities.

Mr. LUETKEMEYER. Ms. McWilliams, Mr. Dimon from JPMorgan Chase was here last week and I asked the question with regards to the impact, and he came back with this comment. He said, "Look, my bank is big enough that we don't have to worry about this. We can absorb the costs. But there are a lot of small banks and credit unions that can't. You are going to see a huge problem with them with regards to pricing on this." And then he said, "Some will virtually have to stop lending because of the procyclical

nature of this thing when we have an economic downturn." Would you agree with that?

Ms. MCWILLIAMS. Based on my exposure and interactions with community bankers, that seems to be a prevailing opinion among the community banks as well.

Mr. LUETKEMEYER. Fantastic. With that in mind, here we have a situation where we have a rule that is being implemented. It has not been studied. It is going to have a dramatic impact on the economy, on the very entities that you all are reviewing and regulating or they are going to have the procyclical nature. This to me, the procyclical nature of this thing, is what is devastating.

Because whenever we have a downturn in the economy, they are going to have to find a way to raise more money, more capital and have to probably cut back on services and lending to the very people whom we want to be able to help.

I would hope that you would be working with me to put some pressure on FASB to just stop and study this. And I appreciate your continued studying of this and working with us. Thank you very much.

I yield back.

Chairwoman WATERS. The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much, Madam Chairwoman.

We need to put a stop right now on FASB's ruling in terms of CECL. This ruling is absolutely devastating to our smaller banks without question and our credit unions. The larger banks don't have to worry about it. They have the capital.

Now, I have been on this issue for quite some time. In December, I even brought up the issue of comparability. As you know, CECL does not prescribe to the use of specific methods to estimate loss allowances. And what this does is it allows these banks to be able to use their own judgment in developing methods that are appropriate and practical under those circumstances.

And this is done to allow these banks who are smaller to have flexibility, and I agree we need to respond to that. But here is the situation. It brings into this a conflict, an inherent conflict.

And I want Chairman McWilliams and Chairman Hood, if you would, to explain to us how do you balance flexibility against comparability? Meaning, how can you ensure the judgment banks use in developing their methods does not impede upon the ability of regulators, like yourselves, and investors to compare the health of the banks across the industry and will not limit the smaller banks and credit unions from being able to make loans? If they can't lend, they go out of business.

Ms. McWilliams?

Ms. MCWILLIAMS. It is a great question, Congressman, and I have to tell you, I met with an MDI in California, which was one of the last MDIs de novo charters granted before the crisis, and they said, "Looking at historic losses, we don't have that data. We will actually have to borrow data from our peers to estimate." So it highlighted for me the issue of how complicated this is going to be for some of the smaller banks, especially the ones that don't have a long history, to do exactly what FASB is asking them to do.

Mr. SCOTT. And that is why there are times, and FASB has wonderful people there, but they are off target here. This thing is very devastating.

Our community banks, our credit unions, they are the ones. They are the backbone of our towns and our cities, communities, not the larger banks. The JPMorgans, the Goldman Sachs, it is not going to affect them. But it will put our credit unions and our small banks out of business.

Mr. Hood?

Mr. HOOD. Yes, sir, I share that very same concern. We, as an agency, currently regulate 529 MDIs. I would like to see them continue. As I mentioned in my opening statement, I will be presenting a new de novo minority depository institution with a new credit union charter on Monday of next week.

I want to make sure it has the resources to succeed, but in this age of what is taking place with CECL, it does keep me up at night. And it is going to take a lot of research and studying with all the stakeholders such as you and others to really make sure our communities don't suffer.

Mr. SCOTT. That is great.

I hope, Chairwoman Waters, that if necessary we may need to pass legislation or something to put a stop to this.

Mr. Otting, it is good to have you with us and I appreciate you and I sitting together over the last couple of years, and then your appointment and concerning the fintechs. And we have discussed our Fintech Act as a bipartisan act that myself and Congressman Barrett, a lot of them have been working on and it deals with the regulation there.

It would be good if you could tell us the status. The last we heard was that you are extending a special order to the fintechs for regulation. Can you bring us up to date on the status of that special order?

Mr. OTTING. Sure, Congressman, thank you very much. First of all, we think the ability to bring new concepts and choices for consumers are important to the future of banking.

What we found is a big part of the small ticket consumer and small business lending is being done by the Internet and a lot of those entities want the ability to operate across a national platform to bring those services.

So what started under Comptroller Curry in 2015 was, could we create a national banking charter to allow those entities to be regulated, to be supervised, to have capital and liquidity and risk management like other banks?

And so we went through that journey, and last year we announced that we would consider taking applications for a national bank fintech for a special purpose—

Chairwoman WATERS. The gentleman's time has expired.

The gentleman from Wisconsin—

Mr. SCOTT. Thank you very much.

Chairwoman WATERS. —Mr. Duffy, is recognized for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman.

I just want to make a quick comment on the chairwoman's questions to the panel in regard to the BB&T and SunTrust merger. I guess it would be my opinion that you should gather all the appro-

priate information, have as many public hearings as you think are necessary, gain as many comments as possible, and then make an appropriate decision.

But the thought that I want to go through the process maybe, like, how we build roads where it takes 5 or 10 years to get an approval, I don't think that should be your model for approving mergers. Get the information, make a decision, and I trust that you all are doing that.

But in regard to the chairwoman's comments in regard to consolidation, I agree with that. That is happening all across rural America and you start to move decisions out of small communities that were vested in those communities and decisions are made in some farther-off town and I don't think that serves our communities as well.

We tried to lift the burden on small community banks with S. 2155, and the chairwoman voted against that, many of my colleagues across the aisle voted against that bill to help small community banks. And I was disappointed in that.

I didn't think it was a perfect bill, but the credit unions and the small bankers all were in our offices saying how important it was to lift the burden off their backs. So I just wanted to make a comment on that.

But, Mr. Quarles, quickly to you, obviously, we have a private sector faster payment system. You are working on Fedwire.

It seems like the innovation has happened in the private sector with regard to faster payments.

If the Fed steps in with Fedwire and we start to have some competition, I don't see how that plays out. Why not just let the private sector take this? Or what role do you see with Fedwire? Thoughts and opinions?

Mr. QUARLES. So, we are considering whether there is or ought to be a role for the Federal Reserve in the faster payment system. We received a lot of comments about that, as you have said. There are strong reasons to want the private sector to be the area where there is innovation and we have seen innovation there.

If the Federal Reserve were to have an offering in the faster payments area, there are statutory standards that we have to meet to ensure that it would be on a level playing surface with the private sector. But no decision has been made, and we are considering the various comments that have—

Mr. DUFFY. And I should correct myself, the real time payment network. Do you have a timeline on that?

Mr. QUARLES. No. We don't have a concrete timeline, but it is under active consideration how we ought to respond.

Mr. DUFFY. Okay. I just want to switch gears. We had a hearing yesterday on the accountability and pay act. To the panel, who do you think should set the pay for CEOs? Should you all set the pay for bank CEOs or credit union CEOs? Should the Congress set their pay? Who should set their pay?

Mr. OTTING. I believe the boards should do that.

Mr. DUFFY. The board should, yes. Anyone disagree with the board should set the pay? And we are trying to look at ratios in pay with regard to the highest paid and the lowest paid. And my

concern is that that is used probably to bludgeon banks and I look at pay and disparity.

So what, Citibank CEO makes $25 million, a lot of money. But I will also point out that LeBron James makes $85 million a year, and I imagine the towel boy, and if you look at the pay disparity there, it is pretty extreme.

George Clooney makes over $200 million a year, right? And I am sure the P.A. on the set and the pay ratio is extreme. Aaron Rodgers, you know, a great Packer, what around $30 million?

There is pay disparity everywhere and I think the point is, don't we pay for performance? Doesn't the private sector say LeBron James, some will say, and we will argue about it, he is worth $85 million.

Some will say he is not worth $20 million. Some will say he is worth $150 million. We will debate that, but the market sets his pay; George Clooney, Aaron Rodgers.

I get concerned when we want to start playing politics with pay. I believe the private sector, the boards, should compete for the best talent possible, whether it is in their bank branches or it is for their CEO pay and pay for the talent that the market demands.

Am I wrong on that? Or should we start talking about not just CEOs, but also talk about athletes and actors and everybody who makes a lot of money?

Mr. Otting?

Mr. OTTING. As as a lifelong Lakers fan, I am concerned about LeBron's pay, if that is—

[laughter]

Mr. DUFFY. Well-played, sir.

Mr. Quarles?

Mr. QUARLES. I completely agree with that and particularly as to the level of pay. There is an appropriate regulatory interest in ensuring that incentives are set properly. But that is separate from the level of pay.

Chairwoman WATERS. The gentlemen from—

Mr. DUFFY. And I am sure the Laker fans would agree with that, too.

I yield back.

Chairwoman WATERS. —Illinois, Mr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman, and I thank our witnesses.

I would like to raise the issue of the ongoing merger of banking and technology, and whether we are ready for it and what you are preparing for that? The giant bank CEOs that I talk to tell me almost to a person that they are in the process of converting their banks into tech firms over the next decade.

Small banks are very worried about competition from fintech and banking by cellphone. Less visible is the encroachment of giant tech firms into things that we would consider traditional banking. If you look at, for example, Amazon offers what appears to me to be a pretty complete line of business credit options, as well as consumer financing options.

These are things that would have traditionally been handled by banks before, but our regulatory system doesn't seem to be matched to this.

This is not a small effect. The market capitalization of our giant banks is roughly $2 trillion. The market capitalization of our giant tech firms is about twice that.

And so the legitimate question arises given the—for example, is Amazon too-big-to-fail? Is it too interconnected to fail?

What would be the implications to our economy of a giant disruption, either due to capitalization problems or cyber-attacks or so on? Should the standards that we hold our giant banks to also be applied to the tech firms as they more and more move into this space?

And so I would, first off, applaud Chairwoman Waters for recognizing this and setting up task forces on both fintech and artificial intelligence, which I will be chairing, along with French Hill, my colleague from Arkansas. And so what steps are you taking to deal with this over the next decade?

I will just go down the line starting with—

Mr. HOOD. We are evaluating the emergence of financial technology and its ability to really bring other folks into the financial mainstream. The area, though, that I have the most concern about, sir, is cybersecurity, protecting the data of our consumers. So that is an area that we are remaining vigilant in as we embrace fintech.

Mr. FOSTER. Yes.

Ms. MCWILLIAMS. At the FDIC, we are in the process of creating the Office of Innovation to look at exactly those issues. I have personally met with dozens of fintech companies and just asked, "How are you prepping banks? Are there any regulatory obstacles in the way?"

Fintech used to be almost a dirty word in the banking world and, frankly, banks have been innovating for a long time. However, the agility with which the technology companies can move and offer products and services to consumers has bypassed and surpassed what the banks are able to do, partly because of the regulatory requirements.

We are looking through our Office of Innovation, how we can modernize both our systems and how we look at technology companies, third-party providers, vendor management, as well as how can we modernize technology for the FDIC as we supervise this now.

Mr. FOSTER. Yes. No, you are also responsible for the resolution of giant failed firms.

Ms. MCWILLIAMS. Correct.

Mr. FOSTER. Have you started to think about resolution plans that may become necessary for giant tech firms as they play increasingly in banking without an as-clear capital rules, for example, and many other issues?

Ms. MCWILLIAMS. Those are not really in our statutory jurisdiction, sir.

Mr. FOSTER. So that at present, you are unaware of anyone that is looking at comparable?

Ms. MCWILLIAMS. It wouldn't be the FDIC.

Mr. FOSTER. All right.

Mr. OTTING. Congressman Foster, as we discussed when I came over and spent some time with you, I think our biggest challenge that we continue to focus on is the partnerships that these technology firms are establishing with banks and making sure that we have clear standards around what those relationships should look like.

I do echo Rodney's comments that cybersecurity is one area that keeps us up at night. All of the agencies want to ensure that we are on top of that and the impact that that has on consumers today in the event that they couldn't go and get access to their ATM or credit cards in this environment for the lack of cash.

So we also have an Office of Innovation that I know has been over to speak many times with your people and we are using that as an inflow of resources when people want to consider either entering the banking industry or partnering with the banks.

Mr. FOSTER. Yes.

Mr. Quarles?

Mr. QUARLES. Thank you. In addition to endorsing everything that my colleagues on the panel have said, the Federal Reserve, in thinking about these questions and particularly the long-term implications of these questions, has an unparalleled research capacity.

And we have used that capacity to think about how the growth and evolution of technology can and is affecting the growth and evolution of the financial sector, both in immediate ways, but also in longer-term ways. And that will eventually inform our supervisory approach.

Mr. FOSTER. The Federal Reserve also chairs FSOC, which is supposed to look at non-bank sources of systemic risk, and so I think that is an important area that I think everyone has to look at here. Thanks very much. My time is up.

I yield back.

Chairwoman WATERS. Without objection, I would like to enter into the record a letter from the Center for American Progress on the various deregulatory proposals advanced by Trump-appointed regulators.

The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman.

And to our witnesses, thank you for your service and for working for the financial stability and safety and soundness of our financial system while at the same time calibrating regulation so that we encourage and maintain economic growth.

My first question is to Vice Chairman Quarles, in your capacity as the chairman of the Financial Stability Board, are you concerned that any of the large European banks are inadequately capitalized and do you see or discern any safety and soundness issues with those institutions?

Mr. QUARLES. I think that the capitalization of the European banks actually has continued to rise. So as I look at the European banking system generally, the U.S. banking system is more heavily capitalized. But that difference has been closing over time, and so the system as a whole is not one that gives me systemic concerns.

Mr. BARR. Given that it doesn't give you concerns, given that European banks are improving in terms of their capitalization, and given that in our conversations you have acknowledged the need for a level playing field in terms of American competitiveness, why is it appropriate for U.S. regulators to exceed standards set by the Basel Committee and impose more stringent capital and liquidity requirements on U.S. firms?

And obviously, I am referring to the gold plating with respect to the G-SIB surcharge.

Mr. QUARLES. That is something that I think we need to consider. We need to consider it particularly in the context of additional capital regulation that has been generally agreed upon internationally but not yet implemented domestically that could, depending on how it is implemented, significantly increase existing capital levels.

Both I and Chairman Powell have said that we think that the loss-absorbing capacity of our system is probably about right. And so as we think about how to calibrate the various elements of our existing system, as well as what may come in the future or will be coming in the future, we need to think about that holistically.

So I would just say we are considering quite actively how to calibrate each of these elements but we shouldn't do it piecemeal but to look at it all together.

Mr. BARR. One editorial comment in your response to a letter that I sent with my colleagues, 28 of my colleagues, expressing concern about the G-SIB surcharge surcharge and American competitiveness, your response did reference the profitability of U.S. banks.

And I just would encourage the Fed as it looks at this to not use profitability of U.S. banks with or conflating profitability with ensuring that capital requirements are appropriately calibrated.

Let me move on to Chairwoman McWilliams on industrial hemp. Just yesterday, more industrial hemp businesses in Kentucky lost access to card services when their card providers stopped offering payment services to businesses designated as CBD and hemp dry product merchants.

I have had constituent businesses tell me that their access to financial products, specifically card services, has actually deteriorated since we de-scheduled industrial hemp in the Farm Bill, and this obviously conflicts with congressional intent. We obviously descheduled in the Farm Bill but also we had pilot programs that were legal under Federal law in the 2014 Farm Bill.

What is the FDIC doing, and frankly the OCC and the Fed, what are all of you all doing to provide guidance and clarity to banks operating under a pilot program who are now operating legally under the 2018 Farm Bill to make sure that banks have the confidence that they can offer their services to hemp businesses that are legal under both State and Federal law?

Ms. MCWILLIAMS. Thank you for that question. There is a lot of uncertainty in this space as you know because of the State and Federal laws differing on marijuana versus hemp throughout the United States.

We are conducting extensive training with our examiners to make sure that they are appropriately regulating these banks and

making sure that our examiners are not applying undue pressure and understand what is legal. We tell banks, in general, follow FinCEN guidance on marijuana banking and hemp banking as well, and, if necessary, file SARs.

We believe the FinCEN guidance provides a clear path for banks on what to do and I generally say if in doubt file a SAR. But in reality they should be also making sure that legitimate businesses, lawful businesses, have access to credit.

Mr. BARR. I am running out of time. Let me just say it would be helpful to have a unified statement from all of the regulators clarifying that industrial hemp is different than marijuana. It is legal under Federal law and State law and therefore these businesses should have access to financial services.

I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion, is recognized for 5 minutes.

Mrs. BEATTY. Thank you, Madam Chairwoman.

And to the panel, thank you for being here and thank you for your presentations.

I have three questions I am going to try to get through quickly, so in advance I am going to tell you some of the questions. I will simply ask you to say yes or no or agree.

I will start with a venture capital question that deals with geographical diversity. And this question is for most of the panel. As you will recall, in 2018 we were told, and it was noted that 4 States saw more than 80 percent of venture capital investment. Those States were California, New York, Massachusetts, and Texas.

While I realize many of our Members come from those States, I am from the great State of Ohio, and oftentimes, in certain parts of the country, we feel that we are left behind, and I believe that we need geographic diversity when it comes to venture capital.

With that said, in my district we have some very successful venture capital incubator organizations that are in their infancy stage like Rev1 Ventures, and another one, Drive Capital, and I would like to see more of them.

And let me just say to you, Senator Chris Dodd said on the Senate Floor during the debate on Dodd-Frank, “Properly conducted venture capital investment will not cause the harms at which the Volcker Rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of Section 619, I would expect the appropriate Federal regulators to exempt it using their authorities under 619(J).”

With that said, your agencies are currently looking at changes to the Volcker Rule. Are you considering exempting venture capital from the definition of covered funds as it applies to the Volcker Rule? And do you believe this could help to spread venture capital investment more evenly around the country, reminding you I come from Ohio, and it is not listed?

And we will start with you, the Honorable Mr. Quarles.

Mr. QUARLES. Thank you, Congresswoman.

We have received a lot of comments with respect to the treatment of venture capital under the Volcker Rule, under the covered funds provisions of the Volcker Rule.

We are actively considering them. We haven't come to final conclusions on exactly how to address that issue but it is a serious issue that is under active consideration.

Mrs. BEATTY. I am going to move on.

Mr. OTTING. I agree it should be opened up and I am supportive. As a banker, we did make those kind of investments, so I am supportive. And also I just want to thank you for going to the OCC yesterday in the Office of Diversity and attending that; you were well-received. I was behind you a couple of hours on the podium, but thank you.

Mrs. BEATTY. Thank you so much. Thank you.

Let me go to another question because the clock is ticking down and I want to get something in for the Honorable Mr. Hood and Ms. McWilliams. Welcome. This is your first time coming before the committee.

As our chairwoman stated, I am the Subcommittee on Diversity and Inclusion's chairwoman. I have asked this question to everyone who has come here, and you will see your two colleagues there are nodding, and it deals with OMWI.

So yes or no, do you know what OMWI is?

Mr. HOOD. Yes, ma'am.

Mrs. BEATTY. Okay.

Ms. MCWILLIAMS. Absolutely.

Mrs. BEATTY. Okay. Can you tell me, do you know who your OMWI Director is?

Mr. HOOD. Monica Davy is mine and she reports directly to me.

Mrs. BEATTY. And she said that yesterday at the hearing very proudly.

Ms. MCWILLIAMS. Saul Schwartz, and I am very supportive of his efforts at the FDIC and we have ongoing discussions about how to improve.

Mrs. BEATTY. And as you know it has been very difficult for them to present data to us because many of the agencies looked at it and made it voluntary. Diversity and inclusion is huge. It is not about checking the box. It is about changing the culture of not only your organizations but across America.

Do you have any idea, and this is back to all of the panel, do you have any idea of what your response rate at your agency is when we ask the questions in those reports that they send with your name on it as approving it?

Mr. HOOD. With my first month in as NCUA's Chair, I have not seen those reports yet.

Mrs. BEATTY. Okay. Then, we will give you a pass.

We will go down here to Mr. Quarles.

Mr. QUARLES. I believe that the institutions we are responsible for supervising have about a 6 percent response rate.

Mrs. BEATTY. Okay. You are right exactly, thank you.

Mr. OTTING. I don't know the exact number. We did find that one of the problems was the way we were asking for that information was going through the portals. And Joyce may have spent time

with you yesterday. We have talked about a new way to do that, but I thought the percentage was much higher.

Mrs. BEATTY. My time is up. Thank you.

Chairwoman WATERS. Thank you very much.

The gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Thank you, Madam Chairwoman, and I appreciate all of you being here. It is heartening to be able to hear some of the comments that you have made in your opening statements.

Ms. McWilliams, when you had noted on your tour that you came to appreciate how intimately involved community banks are in the success of so many local communities, and Mr. Otting, your comments in regards to the CRA making investments in communities that need it most.

The issue I would like to be able to address a little bit today is the need for increasing broadband connectivity into a lot of our rural communities and that I believe that it should qualify fully as a category under community development as it regards to CRA.

Investments into rural buildout meet the call of the nation's most underserved populations. And unfortunately in my home State of Colorado, we still have a lack of connectivity primarily within those rural areas.

Each of your agencies recognize that broadband investment can be folded in under CRA requirements, but as you move forward in the process to be able to modernize the CRA regulations, I would like to be able to encourage you to state it as explicitly as possible that broadband investment for underserved communities is qualifying as a CRA activity.

So would you say that it is accurate that your agency, and Ms. McWilliams, I will just start with you, is a qualifying investment for CRA activity?

Ms. MCWILLIAMS. I honestly don't know exactly under what circumstances it would be or would not be but it is an issue that has been brought to my attention. I know some of our community banks are struggling, especially in rural counties.

It is a double whammy because in a lot of these counties, that one bank is the only banking presence. It is something that is high on my list of making sure we enable these entities to have access to broadband services.

Mr. TIPTON. Great, and if you wouldn't mind following up with—

Ms. MCWILLIAMS. I will follow up.

Mr. TIPTON. —us on that, I would appreciate it.

Mr. Otting?

Mr. OTTING. We do have an expertise in this in the OCC. It is on our website where people go in and see the conditions that serve low- to moderate-income areas. And I do think one of the points you are making is in the new look at the CRA, we plan to identify all the qualified and have those on all of our websites so it is not even a question of what qualifies in CRA going forward.

Mr. TIPTON. Okay.

Mr. Quarles?

Mr. QUARLES. Yes. I don't think that it qualifies currently, but as Comptroller Otting said, it underscores the importance of the

CRA review that we are doing because we hit the themes that we have had in that review have been two.

One, that rural areas are particularly underserved and that the CRA has not worked as well for them, and that expanding the category of investments that can qualify for a CRA is a theme that we have heard both from communities and from bankers as well.

Mr. TIPTON. Because I have heard, with respect now, "We are looking at it. We are focused on it, and we haven't really made a determination whether it qualifies." Is there interagency communication on this topic?

Mr. OTTING. As we plan to introduce the revisions to the CRA, all of us will concur with public input on what should qualify.

Mr. TIPTON. Yes.

Mr. OTTING. I wouldn't say on this particular topic we have it.

Mr. TIPTON. Okay.

Ms. MCWILLIAMS. Now it is.

Mr. TIPTON. Okay. Thank you.

Chair McWilliams, your agency just closed an ANPR comment period for broker deposit rulemaking. From your analysis would you say that that was robust and comprehensive?

Ms. MCWILLIAMS. The rulemaking process?

Mr. TIPTON. Right.

Ms. MCWILLIAMS. Yes, we have received a number of comments. And I thought it was important when I joined the FDIC that to the extent regulations have not been revisited in a decade or 2 decades, that we are able to take a look at them given the changes in the banking channels and the digital channels that are now available that weren't available back then.

Mr. TIPTON. Good. Thanks, I appreciate that. And many of us on this panel do hope that the rulemaking process will be constructive and to be able to provide more certainty for many segments of the industry that have advanced since the savings and loan crisis from prepaid accounts to sweep deposits between affiliated institutions to online services.

Institutions and consumers together I believe would benefit from moving away from an overly broad definition of broker deposits and toward one that is going to be reflective far more of the current banking landscape that we have.

Chair McWilliams, is modernizing broker deposits definition a top priority for your agency?

Ms. MCWILLIAMS. Yes, it is.

Mr. TIPTON. Great.

I am just going to follow up on something that we have been focused on out of our office for an extended period of time and spoke to it in some of the opening statements in terms of tailoring regulations. Have we fully implemented the tailoring that was going to be required, particularly for small community banks under S. 2155?

Mr. Quarles?

Mr. QUARLES. The implementation is not complete but it is proceeding apace.

Mr. OTTING. Yes, as we indicated, most should be completed by September 30th, and all are anticipated to be completed by the end of the year.

Ms. McWILLIAMS. I agree.

Mr. TIPTON. Thank you. I yield back.

Chairwoman WATERS. The gentlewoman from New York, Ms. Maloney, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets is recognized for 5 minutes.

Mrs. MALONEY. Thank you very much, Madam Chairwoman, and welcome to all our panelists. Thank you for holding this important hearing.

There are a great deal of issues that I want to talk about with all of you and I won't be able to get to all of them. I think they are legitimate questions around the new CECL accounting standard for financial institutions, which I know Mr. Luetkemeyer and many others on this committee care a great deal about and that we need to explore in detail.

And I would like to follow up with all of you in writing with specific questions so I can get on to some other questions today. Thank you.

First, I want to ask Mr. Quarles about the overhaul of the Volcker Rule that the agencies proposed last year. As you know, when the regulators finalized the Volcker Rule in 2013, they required banks to report a significant amount of data on their trading activities to the regulators so that the regulators could monitor whether banks were complying with this rule.

You have now been collecting detailed trading data from all of the banks for over 5 years so if there were problems with the Volcker Rule in practice almost all these problems would have shown up in the data.

But when you proposed an overhaul of the Volcker Rule last year, you cited virtually no actual data to support any of the sweeping changes you are proposing to the rule, not even aggregated high-level data. None. Zippo.

Instead, the proposal justified nearly every significant change by citing, "experience with the rule," with no further explanation, no further evidence whatsoever.

By my count, the agencies cited their experience with the rule rather than actual data a total of 37 times in last year's proposal. I know it was 37 because I actually counted it up and that is simply unacceptable.

There is nothing in the law prohibiting the agencies from disclosing this trading data on an aggregated basis to provide transparency into this critically important rule. So my question is, before the agencies finalize any changes to the Volcker Rule will you commit to disclosing aggregated trading data to the public and in a way that properly protects confidential supervisory information and that demonstrates the need for any overhaul for the rule?

Mr. Quarles?

Mr. QUARLES. Yes, thank you, Congresswoman. That is a very reasonable request. We have received it from others as well as part of the comment process. We are actively looking into how to aggregate this data.

The data as we collect it is, as you have noted, confidential supervisory information. Determining how to disclose it in an aggre-

gated way that doesn't disclose the underlying confidential information is not an easy task but we are actively looking at it.

Mrs. MALONEY. When will we be able to have this data to look at?

Mr. QUARLES. As part of our response to the comments as we receive them, we are looking at how we could make some of this aggregated data public.

Mrs. MALONEY. But when would that be?

Mr. QUARLES. We are expecting to complete this next step in the Volcker Rule process over the next 60 to 90 days.

Mrs. MALONEY. 60 to 90 days. Okay. As you know, I look forward to seeing it even if it has to be in a classified environment or whatever. We need to see it. Personally, I think it should be formatted in a way the public can also see it, too.

Mr. Quarles, as you know, Fed researchers have shown that the risk to banks from climate change could be substantial. And I know you and Chairman Powell have both said that the Fed is using its supervisory authorities to prepare banks for climate change.

But I have to say, based on what I have read, I am a little concerned that the Fed's supervisory program doesn't rely on the most accurate and up-to-date data on climate change. So can you just clarify how the Fed actually supervises banks for climate risks?

Mr. QUARLES. Certainly. I think it is important to separate our supervisory program, which focuses on immediate and near-term risks to institutions, from our research program, which focuses on the longer and that is mostly severe weather events and how banking institutions are prepared for responding to severe weather events and the risk management of that.

I'm sorry, my time, or your time has expired. I'm sorry.

Mrs. MALONEY. Thank you.

I yield back.

[laughter]

Chairwoman WATERS. The gentleman from Ohio, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman.

I would like to go down the line with everybody, and I know this has already been beat to death a little bit, but I have a little different take on it.

Let us assume for a second that the FASB moves forward with CECL standards, and since you can't change FASB's independent decisions, are your agencies considering how to count CECL as part of regulatory capital or other capital in the context of the total capital that you are looking for of your institutions?

Mr. Hood, and all the way down.

Mr. HOOD. We are evaluating those options, yes sir.

Ms. MCWILLIAMS. As the CECL implementation is phased out we will have the feedback from the initial stages of implementation and we can make that decision at that time, sir.

Mr. OTTING. Yes, and I think, as we discussed in your office, we are proposing a 3-year phase-in period of that and there is no magic to that number. We said if there are other issues we will be happy to consider that.

Mr. STIVERS. Great.

Mr. QUARLES. And similarly, as we see the consequences of CECL during the phase-in period, we do have the tools to respond on the capital side.

Mr. STIVERS. Great. And I know various people have various levels of concern. I am concerned because I know that you have all responded to required capital. And while FASB is an important organization, they move so slowly that they just now got to it. So I just want to make sure that it is all done in context. So, thank you all for that.

Chair McWilliams, as you know, Dodd-Frank's resolution planning requirements are very complex and burdensome for financial institutions. We are almost a year into and since passage of Senate Bill 2155 that had provisions providing relief from resolution requirements for some financial institutions.

Can you tell me what timeline you expect for banks under $100 billion and under $250 billion to get some clarity on what the resolution requirements are for them?

Ms. MCWILLIAMS. We are well under way in that process, sir. After several years of being able to take a look at the whole in a comprehensive plan, in some cases tens of thousands of pages, we are now able to focus more precisely on the issue areas and that is where we are targeting our relief.

Mr. STIVERS. Yes, I understand. I am asking when. I just asked for a timeline.

Ms. MCWILLIAMS. Soon.

Mr. STIVERS. Soon. That is a great timeline. If you could give me anything more specific, I would love it.

Ms. MCWILLIAMS. Do we have a date? Not yet, but I will—

Mr. STIVERS. Try to give all of us more clarity. "Soon" is great, but I don't know exactly what "soon" means. It might mean one thing to you; to me, "soon" means really soon. So I—

Ms. MCWILLIAMS. I understand.

Mr. STIVERS. I hope you will move forward.

Vice Chair Quarles, the Fed is moving closer to implementing the tailoring provisions of Senate Bill 2155. How do you plan to address industry growth and preserve the spirt of tailoring over time with inflation and economic growth?

As you know, those thresholds are eaten into every year and would you maybe incorporate some type of inflation adjustment so that we are not here debating this again in 2 or 3 years?

Mr. QUARLES. In the comment process we have received a number of comments that suggest that. It is a very reasonable suggestion, and we are certainly taking it under consideration.

Mr. STIVERS. Thank you. I hope you will take a serious look at that. I have a little time left.

Vice Chair Quarles and Comptroller Otting, you guys are modernizing and doing an interagency process on the Community Reinvestment Act and you probably know that many banks don't know before they make a Community Reinvestment Act investment whether they are going to get any credit for it.

Do you expect the process to provide more clarity so that as institutions are making CRA investments, they will know whether they think they can get a credit for it or not?

Mr. OTTING. Absolutely. You point out a very complicated thing among the agencies and geographically that financial institutions, when they don't know what qualifies, have a tendency to go to the mean and be in the most conservative. Generally, those are mortgages.

We intend in the rewrite that one of the four principles is to be able to provide a list of financial institutions would occur, but more importantly to allow people to come to their primary regulator when they have something they think is unique and be able to get a kind of a read on whether we think that would qualify.

Mr. STIVERS. I love that idea. Innovation is going to be so important in that space. Do you think, Mr. Otting, that that could actually result in more investment in low- and moderate-income communities?

Mr. OTTING. I do.

Mr. STIVERS. I do, too. Thank you. And are there—are you considering CRA credits for partnerships with nonfinancial institutions because of so many unbanked people out in this country?

Mr. OTTING. CRA credit for the partnerships or the products that come out?

Mr. STIVERS. The products as a result of those partnerships. I am sorry if I wasn't clear.

Mr. OTTING. Yes. Generally, banks partner and they receive CRA credit for those originated products that are in low- to moderate-income areas. Our new model does give them CRA credit on their balance sheet for that activity.

Mr. STIVERS. Great. And there have been some claims that CRA examinations are too subjective. Is there going to be a move to try to make CRA examinations as objective and consistent as possible, because obviously you sometimes have two different people who say different things.

Mr. OTTING. It is our goal to make the vast majority of it objective so everybody—

Mr. STIVERS. I will submit more question in writing. Thank you. I yield back.

Chairwoman WATERS. The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you, Chairwoman Waters. The Community Reinvestment Act is extremely critical in combating housing discrimination, and also ensuring that all Americans, every single American has access to economic opportunities. If you look at the history of why it was created, you understand the importance of continuing it on.

I know that the CRA statute requires that, "The banks have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered."

So, Mr. Otting, you are considering removing the assessment of branches within low- and moderate-income communities for CRA exams, is that correct?

Mr. OTTING. That is not accurate.

Ms. TLAIB. It isn't?

Mr. OTTING. No.

Ms. TLAIB. Okay. Then one of the things that it also says is that you are proposing to move CRA exams to a "single metric."

Mr. OTTING. That is not accurate either.

Ms. TLAIB. Would remove ability for communities to provide comments?

Mr. OTTING. Oh, absolutely.

Ms. TLAIB. No, you would be allowed to be able to do that.

Mr. OTTING. We would, just as a point of fact, we met with 1,000 different organizations. The Fed went out for comment in 23 geographic markets. We got 1,500 comments in the ANPR.

We have taken that now into context. We are in the process of looking at writing the notice of proposed rulemaking, and then that product will also go out for 75 days of public comment.

Ms. TLAIB. Okay. So, Mr. Otting, one of the things that some of the partner organizations that I am hoping you are meeting with is in the National Community Reinvestment Coalition, which has been really critical for communities like the 13th Congressional District, we saw huge drops in black-owned homeownership, branches disappearing from every corner, and communities in what we call credit deserts.

And so one of the things that came back to me is that they estimated that there would be a loss of up to about $105 billion in home and small business lending nationally over some of the changes in the advance notice of proposal making, the ANPR you are familiar with.

In my district alone, I would be losing about $63 million and in my State, the State of Michigan, about $1.9 billion. So some of these changes are obviously leading to some sort of impact, negative impact, in regards to some of those changes. But I want to talk about your background.

Mr. OTTING. Can I just comment on that for a quick second?

Ms. TLAIB. Sure.

Mr. OTTING. Actually, collectively, our analysis is we expect somewhere between a 15 and a 40 percent increase in CRA investments.

Ms. TLAIB. I understand. And I have to tell you—

Mr. OTTING. So there would be no decrease though this.

Ms. TLAIB. The largest component of the CRA is its ability to block mergers that can harm consumers and endanger the financial system. Is that correct, Mr. Otting?

Mr. OTTING. Say that one more time?

Ms. TLAIB. The largest part of the CRA is its ability to block mergers that can harm consumers.

Mr. OTTING. No. I think the largest part of CRA is that it serves low- to moderate-income communities across America.

Ms. TLAIB. Mr. Otting, while you were CEO of OneWest Bank, the merger with CIT Bank wasn't approved originally because it didn't meet the CRA examination, correct?

Mr. OTTING. No, that is not correct.

Ms. TLAIB. It met the—

Mr. OTTING. No, we passed our CRA. We have a satisfactory CRA.

Ms. TLAIB. Okay. And Vice Chairman Quarles, the Fed didn't support the OCC's ANPR for CRA's modernization. Can you briefly tell me why?

Mr. QUARLES. I hate to make it a theme, but that is actually not correct.

Ms. TLAIB. Oh.

Mr. QUARLES. We didn't go out with them, but that is not in any way unprecedented for one agency to go out with an ANPR. They were going out asking questions. We went out complementarily to seek the same sort of input on potential improvements to the CRA through roundtables that were held by the various reserve banks.

We held 29 different roundtables all around the country. So we were engaged really in the same process as the OCC. We just did different processes because we were different agencies, but we are working together to take all of that input and to come up with a proposal to the CRA that meets the community input and actually improves the regulation.

Ms. TLAIB. So, are BB&T and SunTrust trying to merge? Mr. Otting?

Mr. OTTING. The OCC is not involved in regulating—

Ms. TLAIB. No, do you know that they are trying to merge right now and there is—

Mr. OTTING. Absolutely.

Ms. TLAIB. And it would be the largest bank under FDIC supervision, correct?

Mr. OTTING. Yes. That would be Chairman McWilliams.

Ms. TLAIB. Is that correct?

Ms. MCWILLIAMS. That has not been determined yet.

Ms. TLAIB. It hasn't been determined.

Ms. MCWILLIAMS. Correct.

Ms. TLAIB. Is the CRA playing a role in that?

Ms. MCWILLIAMS. Yes.

Ms. TLAIB. And are they meeting the requirements of the CRA?

Ms. MCWILLIAMS. When the application process is under way, we don't comment on specific applications. They would have to submit a plan to us as to how they are going to tackle different issue areas and statutory requirements under the Bank Merger Act, and that is certainly one of the areas that we will consider.

Ms. TLAIB. Okay. Thank you.

I yield back the rest of my time.

Chairwoman WATERS. The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Madam Chairwoman, and I thank all of you for coming before this committee to answer questions that are important to our constituents back home.

The other day, I was back home and I was speaking with a Vietnam War Veteran, and he was in disbelief that in 2019, we are having to push back against socialist proposals within our own government. It is hard to believe.

I would like to go straight down the line, starting with you, Mr. Hood, and ask each of you a simple question: Are you a capitalist or are you a socialist?

Mr. HOOD. I support the free markets.

Mr. WILLIAMS. Are you a capitalist or a socialist?

Mr. HOOD. Capitalist.

Mr. WILLIAMS. Thank you.

Chairman McWilliams?

Ms. McWILLIAMS. Sir, I grew up in communism, spent some time in socialism, and I choose capitalism.

Mr. QUARLES. Capitalism.

Mr. WILLIAMS. Mr. Otting?

Mr. OTTING. I wish I could give you Jelena's answer. I am a capitalist.

Mr. WILLIAMS. Capitalism wins again. Thank you very much.

Chairman McWilliams, I would like to talk about the pending SunTrust and BB&T merger. There's nothing inherently evil or wrong about two businesses merging together. That's sometimes a great thing.

There are many potential benefits, whether it be tapping into economics of scale or economies of scale, increasing efficiency or greater growth opportunities that private sector management considers when deciding to combine businesses. And you know what? They may even make—don't say it too loud—a profit, and that is a good thing.

So the FDIC is statutorily required to review these bank mergers before they are finalized, yet some of my colleagues from the other side of the aisle are calling for greater congressional control over the process in this particular instance.

So, Madam Chairman, can you talk about the rigorous review process that is undertaken by the FDIC and what you believe that Congress doesn't need to get involved in anymore?

Ms. McWILLIAMS. Absolutely. We have statutory requirements we are supposed to go through and meet under the Bank Merger Act for the size and the complexity of this merger.

Those requirements require us to take a look at and review the effect of the merger on bank competition, the financial and managerial resources of the existing and proposed institutions, the future prospects of the existing and future institutions, the convenience and need of the community to be served, the risk to the stability of the United States banking or financial system, and the effectiveness in combating money laundering activities by the existing and future institutions.

Mr. WILLIAMS. All right.

Ms. McWILLIAMS. And those are just the substantive requirements that you gave us.

Mr. WILLIAMS. Thank you. On May 13th, Treasury Secretary Mnuchin spoke before the National Association of Insurance Commissioners and recognized the challenges in implementing an international capital standard for insurance companies in the United States that are supposed to go into effect later this year.

So, Chairman Quarles, as you know, the United States has the largest insurance market in the world which has been able to flourish under the state-based regulatory regime. Can you explain why the U.S. and foreign regulators are planning on finalizing a new, unproven insurance capital standard in November if our insurance companies are currently well-capitalized, well-regulated, and thriving and customers are benefiting?

Mr. QUARLES. There has been—the Fed participates on behalf of what we call Team USA, which includes the National Association of Insurance Commissioners as well, and the Office of Insurance at the Treasury, has participated in those discussions.

And we have created space in that international discussion about a holding company capital standard for our system, for a building block approach that would allow our system of insurance capital regulation to be recognized as equivalent.

It is now incumbent on us and we are close to presenting a concrete regulation to effect that building block approach. The NAIC is also working diligently to develop their group capital approach. And the IAIS, the relevant international body, has recognized that there is space for that in what is being done.

Mr. WILLIAMS. Okay. Thank you. Technology is a wonderful thing and when used correctly it makes a profound impact on our everyday lives. I have been in the car business for 50 years and I have seen a lot of changes.

When I began, we had to call different banks for financing offers which was a long, laborious process for our customers, but today you can be approved for auto financing in real time, almost instantly.

There are many similar stories in other industries as well and there are now online small business lenders who can provide loans, as you know, in under 24 hours that traditional banks cannot offer. The OCC and the FDIC have committed to help drive innovation in these spaces.

So, Comptroller Otting, how is the OCC playing a role in helping community and mid-sized institutions partner with technology companies for the betterment of the economy and Main Street businesses?

Mr. OTTING. Right. Thank you for the question. First of all, in 2015, we introduced an Office of Innovation at the OCC that staffed a lot of incoming calls and comments. In addition to that, last year we announced that we would allow a national banking fintech charter, a special purpose charter. We produced the criteria for that.

But just as important to your point about a lot of relationships, we're finding a lot of non-banks are able to provide products and services, automobile lending most particularly—

Chairwoman WATERS. The gentlewoman from California, Ms. Porter, is recognized for 5 minutes.

Mr. OTTING. You need a balance sheet to be able to supply that and that is where banks—

Ms. PORTER. Mr. Otting, I don't know if you know this, but we have something in common, which is that we both grew up in small towns in rural Iowa: you in Maquoketa; and me in Lorimor. And we all draw on our life experiences to do our jobs, which is reasonable.

The Equal Credit Opportunity Act, ECOA, makes it unlawful for any creditor to discriminate against any applicant for any credit transaction on the basis of sex, race, color, national origin, religion, age, receipt of income from a public assistance program, or the applicant's exercise of rights under the entire Consumer Credit Protection Act.

Tell me, should we add to that list of protected classes under the Equal Credit Opportunity Act "friends from the inner city?"

Mr. OTTING. From the inner city, ma'am?

Ms. PORTER. Friends from the inner city.

Mr. OTTING. I don't believe so.

Ms. PORTER. Last June you appeared in front of this committee and you were asked if you believe that discrimination exists and you said, and I quote, "I have personally never observed it, but many of my friends from the inner city across America will tell me that it is evident today." When you said, "friends from the inner city," what did you mean?

Mr. OTTING. When I was in California, I had tremendous outreach in communities across the greater Southern California community. And as I was out visiting with those people, people would tell me there were instances of discrimination. You may not know, Ms. Porter, my background, but my in-laws are first generation Hispanic people for this country.

Ms. PORTER. I know.

Mr. OTTING. And so as I meet with—

Ms. PORTER. Do they live in the inner city?

Mr. OTTING. Pardon me?

Ms. PORTER. Since you have raised the issue of your in-laws—

Mr. OTTING. Yes.

Ms. PORTER. Do they live in the inner city?

Mr. OTTING. They do. My wife—

Ms. PORTER. So by, "friends in the inner city"—

Mr. OTTING. My wife was born in the inner City of Los Angeles.

Ms. PORTER. You are referring to—

Mr. OTTING. I was referring to my entire experiences, as you referenced, with friends and family and people that I interact with on a consistent basis.

Ms. PORTER. Who are some of your friends from the inner city besides your in-laws?

Mr. OTTING. John Bryant is one of my closest friends and John, as you know, grew up in Compton, California, and has done an incredible job with his organization of being able to build something that gives back to his community. And I have been a longtime supporter of those activities that John conducts.

Ms. PORTER. So by, "friends from the inner city", you meant black people, poor people, brown people. Why didn't you say, my experiences with—

Mr. OTTING. I just chose—

Ms. PORTER. —those who suffer discrimination in this country?

Mr. OTTING. I chose those words at that particular point in time.

Ms. PORTER. Okay. When I wrote to you on April 1st, I asked you to answer questions about the Community Reinvestment Act. I sent you this letter. It is four pages long, and this is the letter that I got back. "Dear Representative Porter, thank you for your letter dated April 1, 2019. I intend to carry out my duties as Comptroller of the Currency." Would you like to expand upon your reply?

Mr. OTTING. I would not.

Ms. PORTER. Let me continue. This is the entirety of the letter after you say, "I intend to carry out my duties as Comptroller of the Currency", you say, "On a related note, it is disappointing that you have repeated on Twitter unfounded, inaccurate allegations."

And you go on to say, "As a Member of Congress, you have a responsibility to avoid repeating misinformation. Such misinforma-

tion undermines both public and private dialogue to make CRA regulations work better for everyone."

So since you don't want to expand upon your letter, and you didn't reply to my substantive questions, I am now going to ask you those questions in this hearing.

Bank of America, JPMorgan Chase, Wells Fargo, and other banks have the same relationship pricing promotions that Citibank used. Citibank had a fine, which you then dropped, levied against them for preferential treatment of white borrowers in offering home loan discounts.

What have you done, drawing on your experience with friends from the inner city, to examine potential fair lending violations with regard to relationship pricing arrangements at other financial institutions?

Mr. OTTING. We have a fair lending examination at all the major institutions on an annual basis, and we validate and look at all of their processes and programs. And we expect the institutions to do an end-to-end analysis of that. And where there are instances where we find they are in violation of fair lending, we refer those to the Department of Justice.

Chairwoman WATERS. The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. I appreciate the Chair's time.

And I appreciate the panel. I want to thank this panel for their devoted service to the United States. I appreciate Chairman McWilliams being a distinguished citizen of our country now having survived the fall of the Berlin Wall and her experience growing up in Central Europe so it is an honor to have you here before us.

And I want to commend the FDIC and the OCC on recent innovation initiatives that I believe will be of benefit to our depository institutions and to non-banks alike. I appreciate your leadership on that.

Chair McWilliams, your FDIC Innovation Lab is a great step forward and I encourage you to select someone from that office to be managing it as soon as possible.

Mr. Lynch and Dr. Foster and I look forward to collaborating together on issues surrounding fintech and artificial intelligence as it relates to the financial services industry and so much of that is exactly what you are doing in each of the regulatory agencies to maintain a level playing field, maintain access to customers, businesses, and consumers, as well as facilitate innovation inside a giant bureaucracy like our regulatory agencies. So, I appreciate that.

And, Comptroller Otting, I appreciate also your innovation pilot program, which is a strong step forward in fostering a good dialogue between our banks and those other regulators, so thank you for that.

I was interested in the CECL discussion. I won't belabor it but I just want to call your attention, Mark Zandi, who is a frequent testifier before Congress. I am not sure actually how he gets any work done. He is on the Hill weekly.

But when he testified on the subject of CECL under a number of questioners he said, "I don't anticipate the banks actually having

to make any adjustment to comply with CECL." That just begs the question, why is FASB proposing this?

And that really sent, I think, a lot of confusion in our committee on a bipartisan basis that we have changed FASB, we are supposed to go to expected losses, bankers don't really know quite what that means. And we would say, and I think Mr. Luetkemeyer would say we are not sure Fannie Mae and Freddie Mac know what that means or any other entity required to comply with CECL.

But a lot of us don't agree with the question I heard about creating a regulatory form of capital and a GAAP definition of capital. That is something we got away from after the savings and loan crisis in the 1990s.

So while I can't encourage that, I can certainly echo the encouragement from Mr. Luetkemeyer that we, among our regulatory agencies, press FASB for that cost-benefit analysis and a delay, if necessary, in implementing this proposed pronouncement, including checking in with your friends who are Commissioners at the Securities and Exchange Commission that oversees FASB.

One thing I am concerned about, having read the Treasury Report on financial innovation that came out last summer, on behalf of Chair Lynch and Chair Foster and myself, I hope you will spend some staff time and prioritize for us—I know you contributed to that study, but if you would prioritize issues in lending and payments and reg tech and submit those to our fintech task force I think that would be helpful.

And one thing that is concerning I think to banks of all size is standards in innovation, that you all get on the same page. We love that you are doing sandboxes and that you are going to try to facilitate sandbox testing within your regulatory agencies.

We encourage you to move faster on that, Mr. Quarles, as it relates to AML sandbox that I know you have a request pending on, but we need you on the same page when it comes to exam guidance. So I would encourage that FFIEC participates, the FFIEC, also meet and see what they can do now to harmonize on exam guidance for vendor due diligence for fintech companies.

I think it is pretty good if you are at JPMorgan Chase. I think it is very difficult at the non-member State bank exam at the FDIC to get through a vendor due diligence on an emerging technology. That was a big part of the Treasury study.

So will you each commit that you will devote some FFIEC time to exam guidance, even now as we are just on the front end?

Mr. HOOD. Yes, sir, I commit. And I am the incoming Chair of FFIEC, so I especially look forward to it.

Mr. HILL. Good.

Chair McWilliams?

Ms. MCWILLIAMS. Yes. And I am an outgoing Chairman of FFIEC, and I intend to continue—

Mr. HILL. Hand the baton off correctly.

I yield back, Madam Chairwoman. My time has expired.

Chairwoman WATERS. Thank you.

The gentleman from Utah, Mr. McAdams, is recognized for 5 minutes.

Mr. MCADAMS. Thank you, Madam Chairwoman, and good morning. I am happy to have you all before us today and thank you for your testimony.

My question starts with Chairwoman McWilliams, and I want to ask you about a type of bank regulated by the States and by the FDIC: industrial loan companies (ILCs), known as industrial loan banks in my State of Utah.

For decades, the FDIC quarterly call reports document that ILCs are among the safest and soundest financial institutions in the country, yet some suggest that ILCs are underregulated and that the FDIC does not have the authority to provide ILCs or their parent companies with the necessary supervision to ensure that they operate in a safe and a sound manner.

So, Chairwoman McWilliams, does the FDIC have the authority it needs to properly regulate ILCs and can you describe for us what powers you have to examine an ILC and take action against it or its parent company if necessary?

Ms. MCWILLIAMS. Yes, thank you for that question. The short answer is yes, we have the appropriate authorities to appropriately examine and supervise ILCs. We also work with the State supervisors.

In fact, I have met with a great gentleman from your State, who is the superintendent, and we feel that we are appropriately positioned to be able to enforce the existing laws and regulate ILCs.

Mr. MCADAMS. And would you approve an ILC's application for deposit insurance if you believed it would put the deposit insurance fund or the financial system at risk?

Ms. MCWILLIAMS. I don't engage in hypotheticals, and that one is absolutely no.

Mr. MCADAMS. Okay. I want to move to a different topic then. I want to ask a few questions regarding the Community Reinvestment Act and CRA reform for whomever on the panel may feel inclined to respond.

As the Fed, the OCC, and the FDIC work on proposing updates to CRA regulations, I hope that you can all preserve the spirit and intent of the CRA to benefit low- and middle-income communities and individuals while also updating the CRA for a 21st Century financial system.

So a couple of points that I hope to see in CRA reform and then some questions, as you consider CRA reform I hope that you all look for ways to push financial institutions to innovate, to try new data-driven projects while giving those institutions the certainty they need that innovation will be permitted under the CRA for credit.

And I hope that we can reform the CRA to be more outcomes-driven rather than input-driven. And I hope that we don't lose the community-driven purpose of the statute.

So as I said, a couple of questions. The advancement of technology is widely cited as one of the drivers of CRA reform.

How can regulators balance widespread adoption of electronic and mobile banking with the CRA statues—statutes focused on local communities? And how should branches, banks or bank light banks be addressed?

Mr. OTTING. I would be happy to address that. Thank you very much for that question. I appreciate your insight on this and I would love to follow up and have dialogue on this.

Mr. MCADAMS. Thank you.

Mr. OTTING. As we look at the branchless institution, and a lot of those are located in Utah, we have talked to them about what their thoughts were, and a lot of times they say, we want to be able to serve more where our customers are.

So giving them the flexibility not only to serve at their headquarters or where their charter is but looking through their customer base and being able to serve those communities across America. And that is one of the goals that we are trying to accomplish.

Mr. MCADAMS. Thank you. I have spoken to many banks about the Community Reinvestment Act. Traditional banks, banks that do—bank fintech partnerships, and many of Utah's industrial banks.

And one of the things they tell me is that it takes also too long to receive feedback from regulators after a CRA examination has taken place.

Does it make sense to get word back to banks sooner so they can make needed adjustments and so they can better focus on serving the credit needs of their communities? And will CRA reform efforts touch on this point?

Mr. OTTING. I absolutely 100 percent agree with you. I think across all three regulators, we can do a better job of that.

And partly, it is the subjective and the good way that it is done today. And if we can bring a more objective way that it is measured, I think we can dramatically accelerate that feedback.

But also put institutions in a position where they know what the criteria is, and they can be managing that so they know that they are satisfactory or outstanding before we show up.

Mr. MCADAMS. Thank you. I just want to, I guess, reiterate my points then.

As we move to adapt the CRA for 21st-Century technology, I hope that we can still maintain a focus on those communities that are impacted and those communities where those banks may be physically located. Because even if they are serving clients in a mobile and online fashion, they are located in a particular jurisdiction.

But also, as we work to increase our understanding and opportunities to benefit those communities that CRA is intended to benefit or those populations that it is intended to benefit, that we might find ways to encourage better innovation and more data-driven ways rather than the safe ways that have just been kind of cookie cutter in the past.

And with that, I yield back.

Mr. OTTING. Just one comment, one of the core elements of CRA is serving those communities where there are branches not benefitting from that.

Chairwoman WATERS. The gentleman's time has expired.

Mr. OTTING. Thank you.

Chairwoman WATERS. The gentleman from Georgia, Mr. Loudermilk, is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Madam Chairwoman. I appreciate everybody being here. This is an important dialogue that we are

having. And I have a series of questions on various topics that I think are very important to our customers and constituents back home.

But first, Mr. Quarles, you and I have had the conversation in the past about the Fed's investigation or consideration of getting involved in the real-time payments settlement system.

I have expressed my concerns of the government competing with private industry. But Chairman Powell testified to this committee that—he said if the Fed does get engaged in this activity, that the system would be fully interoperable with the private sector network.

My question is, we are not hearing many details, and I don't know that there are many details on this proposed system. Without the details, how do we know that it would be fully interoperable? And have you made any progress in that direction? Do you have any updates?

Mr. QUARLES. We don't have details on the specifics of how it would be interoperable because it is still a proposal that is under consideration and we are considering whether it is something that we would do at all.

But if we were to proceed down that road, it would be a very transparent process. And the Fed is committed to ensuring that people would understand both what we were doing and why we were doing it.

Mr. LOUDERMILK. Thank you. Moving on to another subject, the State of Georgia many years ago passed legislation that effectively outlawed payday loan operations in Georgia.

But what has happened recently is, we have left a portion of our customer base without the ability to get small-dollar loans. And usually that is a segment of society that finds it difficult to find a place to borrow money that they need. In fact, a statistic came out recently that said 40 percent of Americans cannot afford a $400 emergency without borrowing money.

But we have this gap of where people can't borrow money. And Comptroller Otting, I appreciate the OCC encouraging banks to get back into the small-dollar consumer loan market. I appreciate that.

My question, Chairwoman McWilliams, is will the FDIC explicitly state that banks can make these loans, and when may we expect that to happen?

Ms. MCWILLIAMS. It is one of my priorities at the FDIC to make sure that we can reach the unbanked and the underbanked. A lot of that fragment of the population is low- and moderate-income communities that actually need small-dollar credit.

We have a request for information that was available for public comment. We have received a number of letters. We have worked with different groups to understand what are the needs of the communities.

It is my personal belief as well as, I think, good regulatory policy that these products be offered by banks where we can monitor for consumer protection, and we can look for the other signs of weaknesses in the marketplace and what the banks are offering. My preference would be that banks offer these products.

Mr. LOUDERMILK. Do you have any idea of when we may see some activity in that direction?

Ms. MCWILLIAMS. Is "soon" good enough?

Mr. LOUDERMILK. The same definition of "soon" that you gave my colleague, Mr. Stivers. Okay.

Ms. MCWILLIAMS. We will get back to you. We had an RFI report closed under the Administrative Procedures Act.

We need to move forward under a certain timeline. And as soon as I have a little bit more information, I will circle back.

Mr. LOUDERMILK. Okay. Thank you. I would appreciate it, if you would follow up. And in my remaining time, I want to touch on one other issue: the Bank Secrecy Act.

I have a proposed bill that would increase the CTR threshold from $10,000 to $30,000. As you all know, 15 million CTRs are submitted ever year, and less than one-half of 1 percent are used by law enforcement.

And what I am hearing when I am back in the district from small banks and credit unions is this is a huge burden on these institutions.

Mr. Hood, can you comment? Is this a significant problem that you are seeing in the credit union world?

Mr. HOOD. It is a significant issue, sir. Credit unions are burdened by it, and I appreciate the role that you are playing in indexing that $10,000 up to $30,000 in today's dollars.

And I also believe that you are looking at doing it over 5 years. They would appreciate, especially credit unions, having the 5-year cycles, because they would have to adjust if there are tweaks made. So I thank you for what you are proposing.

Mr. LOUDERMILK. But can I follow up on that? One of the issues that we have, and I appreciate the bipartisan nature with which we have addressed this, but we don't provide any immediate relief under the proposal.

How much benefit would it be to maybe go to $20,000 within indexing? Would that provide significant relief?

Mr. HOOD. Anything beyond what is there today we would greatly appreciate, and I am sure the credit unions would as well.

Mr. LOUDERMILK. Okay. Thank you. I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Virginia, Ms. Wexton, is recognized for 5 minutes.

Ms. WEXTON. Thank you, Madam Chairwoman, and thank you to the witnesses for appearing today.

I represent tens of thousands of government employees and Federal contractors who were hurt by the 35-day government shutdown that started in December of last year.

I was encouraged to see banks and credit unions of all sizes respond by waiving fees and offering low- to no-interest loans to help Federal workers affected by the shutdown.

However, regulatory guidance from the prudential regulators was slow to come. Not until the 20th day of the shutdown did guidance come, and then only after Chairwoman Waters sent a letter asking for it. During the shutdown in 2013, it wasn't until the 9th day of the shutdown that similar guidance was released.

And let me tell you why this matters. It matters because, while much of the banking industry took proactive steps to assist consumers who were affected by the shutdown, others did not.

I received many letters and e-mails from constituents who were affected by the shutdown in bad ways, and I want to share with you a portion of a letter from a constituent that I received in the middle of the shutdown:

"My husband and I recently sold our home and put an offer in on another home in the area. The profits from the sale of our old home are sitting in our bank account and are sufficient for us to afford our new home and survive for several months.

"The mortgage financing for our new home was all set before the government shutdown. Our closing date is set for January 28, 2019, on our new house. Today, we learned our mortgage company is denying our mortgage application because I am furloughed. They consider me unemployed and too much of a risk to finance."

Now, this constituent was able to work through it all, and eventually the mortgage was able to go through and she was able to buy the house. But it really never should have happened in the first place.

So I introduced the Shutdown Guidance for Financial Institutions Act, which would require regulators to issue guidance to encourage financial institutions to help consumers and businesses affected by government shutdowns.

I am loath to admit that this will be the new normal, but there is a concern that it will be. We could be looking at another shutdown this year. And I think that, rather than having to reinvent the wheel each time, I would prefer that we have some preparation.

For the panel, are your agencies okay with issuing guidance prospectively that would require that banks or suggest that banks and credit unions work with their holders in order to avoid some of the bad consequences of a shutdown that was not their fault?

Mr. OTTING. Personally, I commend you. I do think it is a great way to look at this and be able to put this in place for people ahead of time.

We would be supportive. We were also a supporter of Congresswoman Waters' initiative, and we did communicate with financial institutions, via the OCC, those guidelines.

Ms. WEXTON. Very good.

Mr. HOOD. And I support Mr. Otting's approach.

Ms. WEXTON. Okay.

Ms. MCWILLIAMS. I support it both as a regulator and as a public servant who lives in Virginia. Thank you.

Mr. QUARLES. That seems very sensible.

Ms. WEXTON. Thank you. Now, I know that it has been addressed pretty exhaustively by other members of the committee, but I do want to add my name to those expressing concern about CECL and FASB's decision to forego a cost-benefit analysis before implementing those requirements.

I am especially concerned about the impact on credit availability for low- to moderate-income borrowers and small businesses. And I, like many other members, have heard from banks and credit unions of all sizes, both in my district and in my State.

And I do have a letter here from Capital One for the committee to add to the record if there is no—

Chairwoman WATERS. Without objection, it is so ordered.

Ms. WEXTON. Thank you.

Now, I am concerned because FASB has created this new standard. They are requiring that there be perfect foresight on the part of the various depository agencies.

And it will have significant and widespread impacts on what you guys are supposed to be regulating, but it doesn't appear that there was much communication going on with you on what the impact will be.

So I know it is FASB's purview, but have any of your agencies done a rigorous analysis of the impact of CECL on credit availability?

Mr. HOOD. We are continuing with our Office of Chief Economists to look into that very issue.

Ms. WEXTON. Okay.

Ms. MCWILLIAMS. It is difficult, because there are so many ways of implementing CECL that our hope is that, with a phase-out and a phase-in period, actually some of the smaller banks have the latest compliance date.

We will be able to get the information from that first tranche of banks that are complying and understand—

Ms. WEXTON. But you haven't been able to do that yet?

Ms. MCWILLIAMS. No.

Ms. WEXTON. Okay. And Mr. Otting?

Mr. OTTING. The large banks are going to run parallel. They are running parallel now. We are starting to see the first output of that.

And what people have said is everybody's portfolio is slightly different, depending upon what products you offer and the length of those products and the type. For example, credit cards are definitely much more affected than small auto loans.

And I think we are supportive. A number of us have met with FASB to try to see if there is a solution. That is why we came up with that 3-year roll-in period to it.

Ms. WEXTON. Phase-in.

Mr. OTTING. And we would be more flexible on that, I think, as we move forward.

Ms. WEXTON. Thank you very much. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from North Carolina, Mr. Budd, is recognized for 5 minutes.

Mr. BUDD. Thank you, Madam Chairwoman, and thank you to our witnesses for your time again this week.

Earlier this week, along with every one of my Republican colleagues on this committee, I sent you all a letter, again, with all of our signatures. And it asked that your agencies move forward in implementing several critical recommendations included in the June 17th Treasury report.

The report, as you know, included recommendations for modifying financial regulations to increase efficiency and promote access to capital and credit.

However, 18 months later, many key items remain unfinished. And these are regulations that your agencies have full authority to change.

I realize that under the new Administration it took some time to make sure you had the right people in the right places, but you sit here today, and in each of your roles, you have been in each of these roles for many months. And as far as I can tell, the agencies have pending proposals laid out by the previous Administration.

Additionally, two proposals were issued by the Fed a year ago: one, the enhanced supplementary leverage ratio, and two, the stress capital buffer, were left over from Governor Tarullo's time here. But they still have not been finalized.

I look forward to each of your responses to the letter, the one, again, that I sent this week. But I know that many of us are frustrated with the lack of action. Since my time is limited today, I want to focus on one item.

Mr. Quarles, can you please explain quickly and give us an update on when the Fed will reexamine the G-SIB surcharge and other international standards placed on U.S. firms?

Mr. QUARLES. There is not a specific timeline with respect to the G-SIB surcharge.

But we are actively looking because it has to be considered in the whole complex of regulation and capital regulation, including some that have only recently been agreed upon conceptually and require significantly detailed implementing work to ensure what we don't want to do is make some amendment to one element of the capital regime, be that the G-SIB surcharge or any other element, and discover that we have set that at a level that is too high given something else that could be coming in later.

So we want to look at this comprehensively and that requires a great deal of work, but it is active work that is going on.

Mr. BUDD. Thank you. Sticking with you, Mr. Quarles, you received a letter earlier this week from 42 Senators regarding concerns about the development of the International Capital Standards (ICS), and that was by the International Association of Insurance Supervisors (IAIS).

It is my understanding that the IAIS is both a member of the Financial Stability Board (FSB), and also claims to act at the direction of the FSB. The Senate letter you received specifically asked you as Chair of the FSB to call on the IAIS to alleviate regulatory uncertainty that the ICS or the International Capital Standards project has created.

And also to ask you to issue a public statement that the ICS is not intended to be a global mandate, and that aggregation approaches to capital such as those being developed by the NAIC and the Federal Reserve as well as other well-developed and proven capital regimes are acceptable for the purposes of the ICS. So, quickly, what is your plan to implement this request?

Mr. QUARLES. So I think the most effective way to ensure that the U.S. capital regime is recognized as part of the International Capital Standard that is being developed by the IAIS, we have accomplished half of that goal, which is to have conceptual agreement at the IAIS at a building block approach, an approach that recognizes the U.S. system, is an appropriate equivalent approach to be included.

Now, the next step really to be effective is for us at the Fed and for the National Association of Insurance Commissioners (NAIC)

here in the United States, to develop our building block approach, our group capital approach.

The building block approach at the Fed, and the group capital approach of the NAIC to put that forward in that international discussion to fill the space that has been created for a U.S. compliance regime to be included in that.

We are actively doing that. We expect to have a proposal out, as Chairman McWilliams would say, "soon." But we will have one soon because we recognize that the process is aiming at a November timeline, and in order to have the appropriate influence on it, we need to have our concrete proposal out soon, and we will do so.

Mr. BUDD. Thank you. In just the few seconds I have left, what studies and analyses have you reviewed to inform your views about how the ICS in its current form—about how that might impact the U.S. economy or other jurisdictions?

Mr. QUARLES. We have staff at the Fed that is devoted to these issues and they have looked at a broad range of data. I can provide you some of the specific data as a follow up.

Mr. BUDD. Thank you. I yield back.

Chairwoman WATERS. The gentleman from Massachusetts, Mr. Lynch, is recognized for 5 minutes.

Mr. LYNCH. Thank you, Madam Chairwoman. Thank you for holding this hearing.

I also want to thank the witnesses for your willingness to help the committee with its work. I do want to follow up on the question asked by my friend from Illinois, Mr. Foster, and it was also raised by my colleague and friend, French Hill, regarding the special purpose national bank charters around fintech, and I happen to be the incoming Chair of the Fintech Task Force.

So I guess the question in principle is addressed to Comptroller Otting. I have been following with keen interest this case out of New York, *Vullo* v. *OCC*. I know that Judge Marrero just issued an opinion on that.

A few takeaways just from that case is that they disagreed with the OCC's interpretation of the National Bank Act, and they also pointed to the long history that State regulators have had in terms of regulating non-bank financial service companies. And I think that they are on pretty solid ground there.

The OCC proposal, the White Paper that you put out and also your position in court would basically wipe out the State regulatory scheme there for consumers, and I worry about that. They have done a pretty good job for about 100 years, maybe a little longer.

And so your proposal would basically exempt these fintech charters from inquiry by Secretaries of State like the one in my State who does a great job, and State attorneys general across the country. It would basically wipe out that entire regulatory framework, and that is not a good thing.

So as the incoming Chair of this task force, I am just curious why you tried that approach? Why not come to us? You are going to need a legislative fix.

You have a lot of people here who are very, very much interested in this topic, and I think you are wasting time by trying to ram this through without our input or through a creative reading of the Act.

I think your time would be better spent in dealing with the task force. We will come back to the full membership of this committee and try to work this balance out. We want to create an innovative space where innovation can actually occur. But we also want to protect the consumer. That is the balance here.

And I think, based on the history, the States have done a very, very good job, and they are quick to respond. We are rather slow up here, because of the scope of interests and the nature of Congress, I guess.

So, you tell me, why not come to Congress? Why not try to work something out that would satisfy the concerns of the States' regulatory systems, but also creates that innovative space that we all want to provide consumers with better choices?

Mr. OTTING. Yes, first of all, congratulations on your new role. I do hope to have many interactions with you on this topic because I do think it is important. I have always been a supporter of the dual banking system, both the State and the Federal. While I do respect that judge's decision, I don't think he got that decision right, and we can debate that maybe over a cup of coffee some morning when—

Mr. LYNCH. I will be happy to, yes, yes.

Mr. OTTING. And I also don't feel that—

Mr. LYNCH. I think Jefferson and Hamilton debated this a long time ago, but on this one, I am probably with Jefferson. I think the States have a role to play. But we can talk about that.

Mr. OTTING. Maybe we will go to the play together. But I also think it opens up a lot of dialogue that, at least from our perspective, that the bank, the national bank does have that right. We also feel it doesn't wipe out the way that you described, that it does make them subject to capital, liquidity, infrastructure, and consumer laws associated with this. So it isn't a black or white, I think, situation.

I have a goal to help consumers have access to small ticket credit, and I would be happy to sit down with you and talk about how can we work together. This wasn't an intent not to work together. I think if Mr. Meeks was still sitting here he would say I have spent an enormous amount of time here up on the Hill talking to people about this over the last year and a half.

So it hasn't been done in isolation. But in your new role, I look forward to interacting with you on this topic.

Mr. LYNCH. So do I. And I think there is a wider conversation we can have, and you have offered some other White Papers that have talked about something like a regulatory sandbox where we can try some of these ideas out before we expose the investing public to any unnecessary danger.

So I yield back to the Chair, and I appreciate the indulgence. Thank you.

I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from Indiana, Mr. Hollingsworth, is recognized for 5 minutes.

Mr. HOLLINGSWORTH. Good afternoon. I want to welcome everybody here. I really appreciate the investment of time that has been made in this hearing.

And specifically, Mr. Quarles, I wanted to come back to something that Representative Budd talked about, the G-SIB surcharge, and I know you and I have had several conversations about this in my office, in hearings, via letters and whatnot.

But I just want to come back to the central point of making sure that we get to recalibrating this rule. And I think as you well put and well-articulated that you want to make sure that this is situated inside this holistic approach, right?

But the original G-SIB surcharge rule was put forth in 2015. You, to your credit and your predecessor's credit, have done a lot of work since then in revising the regulatory framework such that the probability of a firm encountering issues is much less. And the cost to the system will be much less. You should get great credit for that work.

But inside that framework because of those changes, I think that necessitates us taking a look at the G-SIB surcharge. As you said, you don't want to make sure that you revise this on its own, but the other factors have already changed making revising this all the more important and all the more timely.

And I know we have had this conversation, but I wanted to reiterate to you how important I think it is that we take a look at that, and I know that you have a holistic view, and you want to approach this in all parts. But even a really big number times zero progress equates to zero progress, right?

So I really wanted to ask you, when do you think that you will be able, or others on your team will be able to undertake the review of the G-SIB surcharge and understand how we might recalibrate that, whether it is coefficients or otherwise, to reflect today's external environment and the regulatory changes that have since been made since 2015?

Mr. QUARLES. Those are all very fair points, but as far as the timeline, all I can say is that we are looking now at the complex of capital regulations as a whole and trying to determine where to calibrate each element. That includes the G-SIB surcharge, but I don't have a timeline for when that process will be done.

Mr. HOLLINGSWORTH. Well, know that it is important to Hoosiers back home that it be done quickly, and I know that you will do it thoughtfully. I know you will do it artfully. But doing it quickly matters as well.

And I have been disheartened on occasion by what I think are specious arguments in saying, oh, the economy is good, or profits are good, and somehow that excuses us from doing the right thing in terms of building the regulatory framework. The right regulatory regime is right irrespective of where bank profits tend to be today, right? And so I want to make sure that we are thoughtful about that as well.

Mr. QUARLES. I completely agree with you that those are not good arguments.

Mr. HOLLINGSWORTH. Thank you. I appreciate that.

Transitioning topics, a really big jump but sticking with you, I know that one of the other things that is really, really important, and you and I have talked about this before, is ensuring that all of our banks compete on a level playing field, and they compete on a level playing field including their foreign counterparts who may

be headquartered abroad but have an important role to play in our financial system, have an important role to play in Indiana back where I live.

And so I wanted to just ask and better understand some of the reasoning behind this because I just didn't quite get it.

Given that branches and IHCs are separate legal entities, I am just unclear how the liquidity requirements take that into account in ensuring that we get to the right outcome where banks that are headquartered domestically and banks that are headquartered abroad but play domestically have the opportunity to do so on that level playing field, the teeter totter being equal?

Mr. QUARLES. Our proposal is to basically base the tailoring rules, the size element of the tailoring rules on the combined—on the consolidated U.S. operations, the combination of the IHC and the branch was driven by our experience particularly during the financial crisis, but also our experience since. The branches of the foreign banks did require a lot of liquidity support from the Federal Reserve during the crisis and we have seen since the development of the IHC structure and totally appropriately, totally—I mean one would expect it, totally legally. But activities that were accomplished in an IHC moved into the branch because of regulation that has been put on to the IHC. Those activities—if there is some future period of stress that requires liquidity support from the U.S. through the Federal Reserve, that support will now be provided in the branch. So as we look at what is the riskiness of the U.S. operations of these foreign banking organizations, I do think that for us to put out a proposal, the right place to start was to look at the consolidated U.S. operations rather than just the IHC, but we are actively considering comments that we received on it.

Mr. HOLLINGSWORTH. Great. I appreciate that. I know that you will be thoughtful and diligent about that, and I know—I just wanted an affirmation that the goal is parity between the two, foreign and domestic, is that correct? However, the mechanics are to get there and the addition or subtraction, the goal is parity?

Mr. QUARLES. Absolutely correct.

Mr. HOLLINGSWORTH. Right.

Mr. QUARLES. National treatment for the foreign operations.

Mr. HOLLINGSWORTH. All right, thank you.

Mr. QUARLES. Operations of the foreign banks.

Mr. HOLLINGSWORTH. Thank you so much. I yield back.

Chairwoman WATERS. The gentleman from Illinois, Mr. Garcia, is recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Madam Chairwoman.

And I thank all of the panelists for their patient testimony and Q&A engagement.

I do have a question for Mr. Quarles. The Fed issued its financial stability report last week noting a 20 percent increase over the last year in leveraged lending. The report stated that credit standards for these loans have diminished since last fall and highlighted that loans to firms with high amounts of debt now above previous peaks in 2007.

Help us understand what a leveraged loan is when private equity firms like KKR, Bain, and Vornado drove Toys "R" Us, everyone re-

members that, into bankruptcy. Didn't they use leveraged buyouts and debt to do so? Correct?

Mr. QUARLES. I don't know that it was excessive. I don't know all the details of the Toys "R" Us story, but I don't know that there was excessive leverage. That was an investment that was made by private equity firms, and retailers in general have struggled with the move to online commerce that I think was as important a factor as the particular financing structure for Toys "R" Us, but I don't know all the details there.

A leveraged loan is a loan that is made to an institution, to a firm that has high borrowing levels, generally secured by its assets. It is a similar economic concept but differs in legal detail from a high-yield bond.

Mr. GARCIA OF ILLINOIS. In the Toys "R" Us scenario, I think it was pretty simple. Private equity loaded up Toys "R" Us with excessive debt. This is a great example of corporate debt gone wrong.

Moving on, these risky moves by corporations in debt prompted your colleague, Lael Brainerd, as well as former Fed Chief Janet Yellen, five reserve bank presidents, and a host of regulatory experts to advise activation of the countercyclical capital buffer. Yet, the Fed declined to activate the countercyclical capital buffer on March 6th.

Mr. Quarles, why have you chosen to ignore experts and colleagues while simultaneously warning of the risks posed by leveraged lending?

Mr. QUARLES. That is a decision of the Board of Governors. The majority of the Board of Governors, with only one dissent, determined that our framework for considering financial stability risk would not call for turning on the countercyclical capital buffer currently.

Mr. GARCIA OF ILLINOIS. Do you agree with their decision?

Mr. QUARLES. Yes, very much so.

Mr. GARCIA OF ILLINOIS. Okay.

Mr. QUARLES. We have a comprehensive and disciplined methodology for considering financial stability risks every quarter we meet as a Board to consider leverage in households, leverage in businesses, asset valuations, leverage in the financial sector. Consider all of that together and you look at all of that together and financial stability risks are not high enough now to turn on the CCYB under our framework.

Mr. GARCIA OF ILLINOIS. So you agree and you are moving in that same direction. When questioned about leveraged lending at Yale University following the financial stability report's release, you noted that, "While leveraged lending has increased, banks are not keeping these loans on their books." Can you please translate what that means? Are you saying you are less concerned about leveraged lending because non-banks are involved?

Mr. QUARLES. No, that is one element of understanding the potential for financial stability risks. So as opposed to the potential for leveraged lending being an element of a future business downturn.

You would expect financial stability risk if a change in the price of a particular asset or asset class could be amplified through the financial system in a destabilizing way, and that generally occurs

when there are investors in an institution or a vehicle that is exposed to that asset that can run from that asset essentially.

That the holding institution has liabilities that are shorter than the maturity of the asset to which it is exposed. Banks are a paradigmatic example of that.

The leveraged loans, however, are being originated by the banks but sold into more stable holding structures, principally collateralized loan obligations, or CLOs, that have obligations with maturities that are longer than the maturity with the underlying assets which makes them more stable institutions. So from a pure financial stability concern, that reduces the concern.

Mr. GARCIA OF ILLINOIS. Well, you have pretty much run the clock down.

So, Madam Chairwoman, I yield back.

Mr. QUARLES. But in a fascinating way.

Chairwoman WATERS. The gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman.

And thank you to everybody for being here and for your attention.

I was captivated, Mr. Quarles.

But I want to kind of piggyback on some of the comments from Mr. Hill and Mr. Lynch earlier. So, a recent PwC report estimated that by 2030, AI and machine-learning technologies could increase North American GDP by $3.7 trillion and could increase global GDP by $15.7 trillion.

A July 2018 Treasury report on fintech and innovation recommended that regulators should not impose unnecessary burdens or obstacles to the use of AI and machine learning and should provide greater regulatory clarity that would enable further testing and responsible deployment of these technologies by regulated financial services companies as they develop.

So my first question is for Mr. Quarles and Mr. Otting, how do your agencies view the advancements made in machine learning and AI, and what sorts of barriers do you think are currently in place that prevent financial institutions from expanding their use?

Mr. QUARLES. There are a few things I would say. One is that it is relatively early-stage technology but is increasingly developing very rapidly and is increasingly broadly available. Two, it is costly and that is something that—

Mr. GONZALEZ OF OHIO. But that is going down, right, significantly?

Mr. OTTING. It is going down but the amount that the financial sector has to spend on technology is going up, so the cost of any particular element. But the amount that we—in part for cyber prevention, in part for keeping up with competition, is very, very costly.

Third, from a purely regulatory viewpoint, one of the points of machine learning is that you develop algorithms so that it can improve their predictive capacity over time in ways that you are not directly.

And that, indeed, even the creator of the algorithm may not perfectly understand, simply know that the predictive capacity is improving over time. And from a regulatory point of view there are

consumer protection and other aspects that we need to ensure that we can appropriately regulate even while allowing that technology to develop.

I think Randy's comments are accurate. I have a couple of other observations. We have seen it start to come into the AML BSA space where they will feed in a hundred violators in particular institutions and then go through their entire client base very quickly and identify characteristics, generally high volatility of money.

We have also seen it be used in the underwriting of credit processing. And as Randy said, there is a little bit of, we are used to seeing what is the FICO? What is the VTI? What is the loan-to-value? And the machine is making decisions on the fly.

And so, the ability to go in and examine that is a complicated aspect to that, but we do see lots of institutions, especially in the model area, looking at how that technology can be used. I think it has tremendous applications in the future.

Mr. GONZALEZ OF OHIO. Great. Thank you.

And then on the issue of data privacy, which you kind of alluded to, there is an evolving framework, a regulatory—regulatory requirements, financial institutions have a responsibility and obligation to protect customer data. And to be clear, subject to Federal data protection privacy laws including Gramm-Leach-Bliley.

A complicating factor is we have a mess of international, Federal, and State standards. I would love to hear, again, Mr. Quarles, what regulatory framework would you propose with respect to data and privacy? Because I think that is one of the big factors that are limiting us here.

Mr. QUARLES. It is a great question. I don't have a great answer for you. It is a very complex question because it plays internationally and domestically.

I think the best I could do for you today is that I would be glad to work with you on this because I think it is a very important question.

Mr. GONZALEZ OF OHIO. Great. Sort of shifting then to ask it a little differently, GDPR, how would you say that is done and where would you, if you could recalibrate that or use that as it appears there is a line in the sand, how do you evaluate that?

Mr. QUARLES. One of the issues that we have run into with GDPR, to just give an example, is that purely from a regulatory point of view it actually has impeded some of our regulation of the safety and soundness of firms because of our inability to access some data under the GDPR standard.

We are working through that. I think we will be able to work through that, but it is just an example of the unintended consequences of some data protection regulation.

Mr. GONZALEZ OF OHIO. Okay, thank you. And I will definitely be taking you up on your offer to have deeper discussions on this. I think this is one of the most important and interesting questions that this committee and all committees, frankly, are going to be dealing with over time.

So thank you, and I yield back.

Chairwoman WATERS. The gentlewoman from Pennsylvania, Ms. Dean, is recognized for 5 minutes.

Ms. DEAN. Thank you, Madam Chairwoman. In my limited time I am going to try to do three things: one, is going to be a request regarding language; two, is going to be to ask one of you about what we should think about the massive fines that have been imposed upon the banks; and three, if I can, payday lending.

So, number one is a request. Before I got here to Congress, before I came to public service, I was a teacher of writing at LaSalle University. And one of the things I told my students to be aware of was euphemism. Euphemism in your language can be very dangerous. It can fog over what—those whom you regulate.

So I will just read you a couple of sentences and ask you to take the lead when you are writing so you can make sure that we as consumers, as Members of Congress, and those whom you regulate understand. Sentences like, "Operational risk is elevated as banks respond to evolving in increasingly complex operating environments. Additional factors contributing to elevated operational risk are the expected increase in mergers and acquisitions activities, as well as rising trends in fraud and attempted fraud. Operational disruptions underscore the need for effective change management when implementing."

You can see there is a lack of nouns and verbs and things we can see in there. I ask you to take the lead and make it clearer for us, and clearer for our consumers.

We had the big banks in here a couple of weeks back. It was a very enlightening hearing. And I don't even have a current tally, but one of the themes that kept recurring was that since 2008, the banks have suffered or have been imposed upon with more than $300 billion worth of fines.

And I am wondering, what is your reaction as very important regulators to that climate? That while they came in and said they are healthy and they have reduced risk and they have streamlined and they are profitable, they have suffered fine after fine after fine. And so consumers think, well, is that just the costs of doing business?

So what do you as regulators think of $300 billion-plus in fines on the big ones, Bank of America, JPMorgan Chase, Citigroup, Deutsche Bank, Wells Fargo, and I can go on and on and on. Your thoughts, the alarm bells that you hear?

Mr. OTTING. For me, the fine is the output of actions that we have found in those institutions we found unacceptable. And while people may say the fines are just the cost of doing business, I can assure you all of us as primary regulators are in the institutions making sure that if a bank is not in compliance with consumer laws or regulations, that they are getting consent orders and matters requiring attention.

And so I would say to you that at least from the OCC-regulated banks, I am very comfortable that we are onsite. We are regulating those institutions and fines are the byproduct of when we find harm in activities. And often what that is is it is the output and it is a couple of years down the path when those actually occur.

Ms. DEAN. I appreciate that, and don't get me wrong. I think you are doing your job. It is just incredibly grave that these are the massive fines with industry that comes in and says we are good,

we are streamlined, we are doing well. And what does the consumer actually see when a massive fine is imposed?

So I am gravely concerned about that. If that just continues, it means that you are doing your job, but they are not doing their job since you have to impose these kinds of fines. So I worry about that.

I don't know if anybody else wants to say something, but maybe I will switch to payday lending, and try to get everything in. I am concerned about payday lending. Again, with the notion of language, I am worried that we now have these things called PALS. Short-term loans may not be a pal to us.

I am very worried about it. I appreciate the FDIC and others saying they want to make sure that there are important terms and regulations. What are you looking at in terms of the guidelines, the requirements, the regulations for short-term lending, as in interest rates, terms, amounts, those kind of things to protect consumers?

Mr. HOOD. Representative Dean, that is an issue that we are looking at, at NCUA. We are looking at low-dollar loan amounts to see how we can bring more people into the economic mainstream. We are looking at, are these products at a good interest rate? Are they also able to build credit so they can really have a credit score so they can be permanently part of the banking system?

Ms. DEAN. What kind of interest rates would be appropriate for short-term lending so that people don't get into a debt trap?

Mr. HOOD. At NCUA, we have a statutory cap of 15 percent on loan balances. Our current payday alternative loan product was priced up to 28 percent.

Ms. DEAN. Yes. Does anyone else want to talk about payday lending? It is a growing market. I think it is an incredibly dangerous market, so your thoughts as regulators?

Mr. OTTING. While the short-term payday lending is under the jurisdiction of the Consumer Financial Protection Bureau (CFPB), most of the banks where we would be involved is when they have a short-term loan. And we have come out with a bulletin on that and I would be happy to send that over to you so you could take a look at that.

Ms. DEAN. That would be great, thank you. Thank you all.

Chairwoman WATERS. The gentleman from Wisconsin, Mr. Steil, is recognized for 5 minutes.

Mr. STEIL. Thank you very much, and thank you all for being here today. I want to spend my limited time on two questions. First, Mr. Quarles, I know that many of my colleagues have already raised concerns about the international capital standards being developed by the International Association of Insurance Supervisor.

I want to echo those concerns. I also want to point out that both of my State's Senators, a Republican and a Democrat, sent you a letter expressing their concerns.

To me, this shouldn't be a partisan issue. It is not really a Democrat or Republican, liberal or conservative issue. I think it is about defending our insurance markets from imported and sometimes incompatible regulations.

I listened to your speech you gave earlier this year and you said that much of ICS's evolution has been in the direction of evaluation

method and overall framework that reflect approaches used elsewhere in the world.

And then you said, “This may not be optimal for the United States insurance market.” Can you elaborate on what you meant there? And would importing incompatible capital standards from Europe or elsewhere harm American consumers?

Mr. QUARLES. We have a particular capital regulation regime in the United States that has supported a healthy industry over a long period of time. It is quite different from the capital regulation regime in Europe and in other parts of the world.

And the IAIS’s effort to develop a global capital standard is a perfectly worthy one, but all of that is voluntary. They are developing a voluntary standard so it couldn’t be directly imported into the United States.

But it also wouldn’t be effective in achieving its objective if it leaves out the U.S. system, an approach that would work for the U.S. system. So they recognize that and the negotiating team, staff from the Fed and from the Treasury and from the NAIC have, as I have said, created space in the process for a U.S. group capital standard to be equivalent to anything the Europeans might use.

It is now incumbent upon us to come up with the concrete implementation of that and we are in the process of doing that. It should come out very shortly.

Mr. STEIL. I appreciate that, and I would appreciate it if you would continue to keep us updated as you work on that important topic.

I want to shift gears, Mr. Quarles, and touch base here on some of the international bank tailoring. In particular, the Fed recently released a proposal on capital and liquidity requirements for banks that have a foreign parent.

I have heard from some concerns that this rule may unreasonably raise liquidity requirements for foreign banks operating in the United States. And it seemed like maybe your comments at the Senate earlier this week confirm that point.

Meanwhile, the Fed is proposing to reduce liquidity requirements on many domestic firms of a similar size. There are several foreign banks in Wisconsin that are active, in particular for consumers across the State, agriculture, small business lending, so it kind of comes to the forefront.

And with multiple firms competing in the market, ultimately consumers in Wisconsin and across our nation benefit from that competition choice and ultimately lower prices.

So with that in mind, I am concerned about what the higher liquidity requirements may have in the Fed’s proposed for foreign banks may ultimately end up hurting consumers in Wisconsin and across the United States. Could you just take a moment to explain the Fed’s proposal on the higher liquidity requirements for foreign banks?

Mr. QUARLES. I think that the comment that I gave was with respect to the aggregate. I think we do have a calculation that in the aggregate across all of foreign bank operations in the U.S. that there would be an increase in liquidity requirements.

But there is a much greater variety of business models among foreign banks of a particular size than there are among domestic

banks of a particular size. And there are banks such as some of the foreign banks that are operating, they are active in Wisconsin, that are pure commercial banks really.

And then there are banks of a similar size with respect to their U.S. operations but that are trading banks. They are investment banks. They have much more complicated securities operations.

And so our system for banks of—given that diversity of business model, the system we have proposed will result in much different treatment of firms of the same basic asset size than they would for domestic banks of that same basic asset size, which will—that, again, at the size of most of these foreign banks in the U.S. would have business models that are much more similar to each other.

So I would be happy to get into the discussion of the specifics of the banks that are operating in Wisconsin, but I wouldn't assume because of the aggregate effect that those banks would be affected in the same way.

Mr. STEIL. I appreciate your clarification.

And I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Connecticut, Mr. Himes, is recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman.

And thank you all for being here. I want to pick up on a line of questioning that Mr. Garcia started around leveraged lending. I will remind you that when the CEOs of the big banks, all but Wells Fargo, were here, I asked them one question, which was, what financial product or mechanism worries you the most?

And I did not hear the economy, not cybersecurity, not financial instruments or mechanisms. There was near unanimity around leveraged lending and in particular it was paired with shadow banking. A number of them said that.

So I want to hear a little bit more on that topic. I have had the opportunity to talk to Mr. Quarles about this, so Mr. Otting, I will start with you. but I also want to leave time for Ms. McWilliams to address the question.

Mr. Quarles was soothing in addition to being captivating, and Mr. Otting, there was a change in tone that you have had on this issue. You, in Las Vegas years ago, said, "As long as banks have the capital I am supportive of them doing leveraged lending, but you have the right to do what you want." I am sure you remember that speech.

A year later in your testimony today you say that a specific credit risk that warrants attention involves the leveraged loan market. I detect a slight change in tone there. So I hve two very specific questions, and I will ask Ms. McWilliams the same questions.

First, I understand that you are monitoring, but are you considering doing anything with respect to banks on their balance sheets? And if not, what would it take to actually do something, take some regulatory action?

Second, I am almost more discomfited by the shadow banking question. And I heard Mr. Quarles. I understand that CLOs get bought by what he calls more stable holding structure by non-banks. The problem is non-banks borrow from banks.

So question number two for both of you is, what kind of visibility do you have into that exposure, that transmission line into from the shadow banking or non-banks?

Mr. Otting?

Mr. OTTING. First of all, on the first question really quick, I still have the same position that a bank's board and management get to make a decision on their leveraged lending. A couple of items got left off that quote. I said that they have to have the people, the risk management, the policies, the capital, and the liquidity to play in that particular space.

I still feel that today. However, I would also say that the guidance that we put out as an industry, as a group of regulators, I think has helped the banking industry to stay at acceptable levels from an underwriting perspective of stuff they are putting on their balance sheet.

The national banks that we regulate have about $100 billion of leveraged lending on their balance sheet, and they have about $100 billion of CLO. So that is $200 billion on $12.2 trillion so it is a little bit less than 2 percent.

But where we are concerned, I don't have this concern as much about the banks that we regulate as that product is created and pushed into the market.

And that is what Randy commented on earlier is we have all done an enormous amount of work as primary regulators and as members of FSOC and we continue to do that work about trying to understand the risk if in the event there was a 30 percent reduction, or a lack of liquidity in that market segment.

So that is my comment. I hope I addressed your issue on the leverage—

Mr. HIMES. And I don't disagree with your words. It was just a change in tone I was pointing out. And you got to the second part of my question, and it sounds like you understand that in addition to the balance sheets there may be indirect transmission—

Mr. OTTING. That is right.

Mr. HIMES. —out of this product. I do want to leave Ms. McWilliams a little bit of time to answer the same questions, but with what degree of urgency are you looking at that?

Mr. OTTING. The other thing that we have come out and had dialogue with the banks on is the indirect process. And you had commented on some, but we also have asked the banks to look at kind of the food chain in their—in the corporations that they deal with that their companies are doing business.

And what I mean by that is suppliers—are they overleveraged that you could disrupt your business? Because if you have a very successful banking relationship with a company and then you don't know their supplier is highly leveraged then they go out of business, it is going to impact your company. It goes all the way down from distribution to end customer.

And then the sideline, which you touched on I think, is, a lot of these funds—some of them are leveraged, some are not. That is where you also have additional exposure of these funds are investing into CLOs that you understand the volume of that activity also within the balance sheet of the banks.

Mr. HIMES. Thank you.

Let me see if Ms. McWilliams has anything to add to that?

Ms. MCWILLIAMS. I will talk very fast. Most of our small banks would have CLO exposure or shared national credit exposure to the extent that they are engaged in leveraged lending.

We have just undertaken the shared national credit, the so-called SNC review among the agencies to understand exactly what the underwriting terms are and what the exposures are. With respect to the CLO exposures at small banks, they are not that great and we are able to monitor those through our supervisory channels.

With respect to your second question as to how are we looking at the non-banks in this space, we are talking to the market regulators on a consistent basis, specifically the Securities and Exchange Commission as well, to make sure that they can monitor and tell us what feedback they have from their participants.

And then just kind of having the aggregate picture as to where the exposures are and where we need to be concerned.

Mr. HIMES. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you.

Mr. HIMES. I think the shadow banking question is important. I will take this up with the SEC, but I worry about that.

Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Virginia, Mr. Riggleman, is recognized for 5 minutes.

Mr. RIGGLEMAN. Thank you, Madam Chairwoman. As you can see, I am dismayed that I can't have more than 5 minutes with you, but you are probably ecstatic.

So I just want to—I don't want to scare you right off the bat, but I have done this for a while, so I did read the actual 2015 DHS SSP. Also, the 2017 Treasury Report and Section 105 of the Cybersecurity Act.

And the reason I did is because I think you guys have some real challenges. So this is not a "stump the dummy" thing at all as far as questions are concerned.

As I go into this, just know that earlier, when we were here with the CEOs, they agreed that cybersecurity is their biggest risk and concern.

I think we talked about A.I. and M.L., and I will tell you, I would love to talk about that, but I think there is a bigger concern based on my background. And this is what I want to get to the heart of. And I think you guys might find this, too.

I find my biggest challenge in multi-intelligence or combined operations, when I did that in the military and also as a CEO, was information sharing. And I know that there could be some rice bowl protections or stovepipes of excellence that we deal with as we go forward in information sharing.

So when I was reading the 2015 DHS SSP, since we are near the end, to have a little bit of fun, I wanted to see how many groups were actually involved in that SSP. I thought it wasn't too bad at first.

There was the Department of the Treasury, the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security, the FSSCC, and the FBIIC, which is the Financial and Banking Information Infrastructure Committee.

So I started looking under the FBIIC and it had the Fed, the OCC, the FDIC, the NCUA with Treasury, the CFPB, the CFTC, the CSBS, the FCA, the FHFA, Fed Chicago, Fed New York, NAIC, the NASAA, SEC and the CIPSEA.

When I look at the type of challenges that you might have with information sharing, reading the 2015 Act, the 2017 Act, reading Section 105 in the Cybersecurity Act, I do have some questions and I do want to—I know I was 2 minutes, but you don't have to answer it for long.

Again, this is not a quiz, I promise you this. Looking at what they were supposed to do with harmonizing regulations, when I was looking at that I think harmonization is really streamlining and getting our information sharing in place and as far as sharing technologies.

My first question to you, and you can each answer for 30 seconds, which is not very long and that is why I wish I had more than 5 minutes with you, is how are you collectively working to harmonize cybersecurity requirements? And I can talk to you, we can start with you, Mr. Quarles, and go right down the line.

Mr. QUARLES. So we meet regularly through—principally through or most frequently through the FBIIC, as you said, the FBIIC. All of those agencies do meet to discuss cybersecurity regulations, cybersecurity risks also other Federal Government.

We also regularly interact with the bank regulatory agencies frequently on issues concerning regulation and a number of those will be cyber regulation. We work with the Treasury as well under the President's working group on some of the cyber risks.

You are absolutely right, it is a big task but it is one to which a lot of resources are being devoted.

Mr. OTTING. I would echo Randy's comment and then I would also say, we talked in your office. We have also done a number of drills with Treasury where we have taken various aspects of the industry that would be taken over by cybersecurity and what would be the playbook that all of us as regulators and the Treasury would be able to execute on.

Mr. RIGGLEMAN. Yes, ma'am?

Ms. MCWILLIAMS. Likewise, I would echo those comments as well. Internally at the FDIC, we take a look at that at our institutions very carefully and make sure that they understand what would happen in a cyber incident.

Mr. HOOD. And in my first month at NCUA I will now make this another priority. Cybersecurity is an issue that keeps me up at night. I will be hoping to address some of these issues through my membership on FBIIC.

Mr. RIGGLEMAN. Sir, do you think there are too many cooks in the kitchen when it comes to enough regulatory agencies? That is a very sensitive question and you guys don't have to answer that. I understand if you don't want to.

I don't want anybody to get sort of scared out there, but do you think there are too many cooks in the kitchen when it comes to this?

Mr. OTTING. Are you asking all of us?

Mr. RIGGLEMAN. I would ask—actually I can ask all of you. I was just asking the last person to answer the question, so—

Mr. HOOD. I think it is great to have a number of sets of eyes looking at this where you all come from such differing points of view and perspectives. My looking at credit unions all the way up to the Federal Reserve, looking at some of the largest institutions among us. So I think it is healthy to have differing viewpoints and differing items for debate and discussion.

Mr. RIGGLEMAN. It has been 4 years since the SSP. Do any of you think it is time to rewrite it? You know, 4 years ago we were still using relational databases. Now, we are using graph analytics in a way that we have never used them before.

Do you guys think it is time for a re-look at the DHS SSP from 2015 and also the 2017 Treasury Report?

And I will have Mr. Otting actually answer that question.

Mr. OTTING. Have we looked at it?

Mr. RIGGLEMAN. Yes, do you think it is time for a rework of the 2015 SSP?

Mr. OTTING. I think that is a long period of time like most things, especially as fast as that is moving that you should do a re-look.

Mr. RIGGLEMAN. Yes, I think harmonization, and I know we talk about integration is probably one of the most important things. We can talk about A.I. and M.L. and technology, but I think once we get our information sharing under control and harmonize our cyber defense posture, I think we have a good way forward. Thank you.

Chairwoman WATERS. The gentlewoman from North Carolina, Ms. Adams, is recognized for 5 minutes.

Ms. ADAMS. Thank you, Madam Chairwoman.

And thank you for being here today.

Madam Chairwoman, thank you for convening the hearing. I won't go into so much preliminary because I think I have heard a lot of that from some of my colleagues.

I did want to follow up though on Chairwoman Beatty who talked about diversity and inclusion and how important that is and not just simply checking the box.

Mr. Hood, you indicated that you are the new kid on the block. Even though you haven't had a report from your person, I am assuming that all of you are probably aware that your numbers are low as of this reporting, so I guess my question is, what are your plans to increase participation in providing diversity self-assessments? That is my first question.

Mr. HOOD. Monica Davey, who reports to me, runs our Office of Minority and Women Inclusion, so I will be working with her to see how we can really raise the level of participation.

Ms. ADAMS. All right.

Anyone else?

Ms. MCWILLIAMS. I have made this a priority of mine as well. We have a diverse workforce and we will continue to increase those numbers.

Mr. OTTING. Congresswoman, your question was, how do we get greater participation?

Ms. ADAMS. Right.

Mr. OTTING. One thing that we found as we explored with Joyce Cofield, is we are sitting the data to the portal of the banks, and we would recommend next year that the leaders of the agencies

sign the letters with the administrators of the program. And we think that would help the participation.

Ms. ADAMS. Yes, sir?

Mr. QUARLES. Yes, I agree with you that the participation is too low, and we would make that a focus of our supervision examination of the banks to encourage them to increase that participation. We think that is important.

Ms. ADAMS. Okay. I taught for 40 years, and sometimes when I would give students things to do on a voluntary basis, they wouldn't do them, so we would make it mandatory. So you don't think we should make it mandatory that you do it?

Mr. HOOD. Yes, ma'am.

Ms. MCWILLIAMS. I would have to figure out exactly how it would be done.

Ms. ADAMS. Okay.

Mr. OTTING. I think we should look at what data we are asking for, and could we get that, so I would agree with that.

Mr. QUARLES. Our interpretation of the law is that we can't make it mandatory, that it is a voluntary program.

Ms. ADAMS. All right. Thank you. So of the scarce diversity data that has been shared, what type of analysis or trends have you noticed about regulated entities' diversity and inclusion efforts? Anybody can answer that.

Mr. OTTING. We have noticed that in the upper levels of the organization, there is much more representation of both female and minorities at the upper levels of those organizations.

Ms. ADAMS. Okay. Anyone else? Okay. Has any guidance been provided to bank examiners on how to evaluate or assess diversity and inclusion practices at regulated entities? Does anybody want to respond?

Mr. OTTING. I am not personally familiar with it.

Mr. HOOD. Not to my knowledge, either.

Ms. MCWILLIAMS. I would have to go to our policy statements to understand exactly what is—

Mr. HOOD. I would be happy to follow up.

Ms. ADAMS. Okay. Now, most of you indicated that you have an OMWI Director and that that person reports, I think you all said to you directly. Are there other entities or people at your agency that may be accountable for the diversity results or is it just that one person?

Mr. OTTING. I think our entire organization is accountable.

Mr. HOOD. For us as well, the entire organization bears a responsibility for fostering a culture of diversity and inclusion.

Ms. MCWILLIAMS. Likewise at the FDIC, and it is an emphasis for senior management to increase diversity.

Mr. QUARLES. And similarly at the Federal Reserve.

Ms. ADAMS. Okay. Thank you.

Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. The gentleman from New York, Mr. Zeldin, is recognized for 5 minutes. We have a hard stop at 1:30, and we are not going to hold the panel over, so—

Mr. MCHENRY. The Minority has actually communicated about the hard stop and that is why I raised it with you. We don't want to hold people here longer.

Chairwoman WATERS. No, no, no, we don't. We are going to move ahead with Mr. Zeldin and then we will talk about it later, please.

Mr. Zeldin, you are recognized for 5 minutes.

Mr. ZELDIN. Thank you, Madam Chairwoman, and thank you to our panel for being here today.

Chairman Hood, congratulations on your recent appointment. As you know, back in March, I introduced H.R. 1661, legislation that would provide the NCUA Board flexibility to increase Federal credit union loan maturities.

Since the current regulations on maturities for credit union lending are stuck in the 1940s, this is making it difficult for hard-working families on Long Island, where I live, to get a loan for a new home or a new business at their credit union.

In my district, we know who the credit unions serve. Overwhelmingly, it is our public servants such as teachers, first responders, nurses, and law enforcement.

I introduced this legislation in a bipartisan manner with another member of this committee, Congressman Vicente Gonzalez. We are also proud to have added five additional co-sponsors to this bill on both sides of the aisle, including another member of this committee, Congresswoman Joyce Beatty.

Chairman Hood, I was excited to see in your written testimony that you stated this bill is a top legislative priority for NCUA. Can you highlight some of the benefits of this legislation as well as the potential consequences that our hard-working families who are credit union members may face as a result of Congress not acting?

Mr. HOOD. I think for some of the issues you raise, Congressman, the fact is that the shorter maturities that we have now is preventing many of these individuals from having access to mortgage lending opportunities, and I daresay perhaps even business lending opportunities.

The more we can do to get the regulatory relief that we need to serve hard-working men and women, I am for it. I would be happy to work with our members at our agency to really see if we can get more attention to the bill that you have proposed.

Mr. ZELDIN. Thank you for your powerful message today, including your written testimony, and for being here.

I would like to pivot to Vice Chairman Quarles. I represent the east end of Long Island, which I would argue is the greatest congressional district in America. This time of year, it is not that hard to make that argument. It is a little more difficult in February during the nor'easters, but it is pretty nice right now. You should come visit.

When it comes to many policies, especially regulatory policy, what makes sense for my constituents when it comes to insuring their businesses, their automobiles, their families, and their homes may not make sense for constituents in a different State, or in a different community.

For example, almost all of my constituents live in coastal communities, so the insurance products they need are going to be different than the insurance products that someone might need who, say, is 1,000 miles away inland.

Vice Chairman Quarles, I commend you for your leadership on the FSB, and I agree that it is important for the U.S. to lead and

to coordinate with our global economic partners. But I want to be clear that it is essential in any of those negotiations that you preserve our State-based system of insurance regulation.

Can you clarify if you believe a European-style system of insurance regulation and capital standards would work in the U.S.?

Mr. QUARLES. I think it would be difficult to make it work in the U.S., but there is nothing that is being discussed by IAAS that would be required to be implemented in the United States.

Mr. ZELDIN. And just for those who are trying to understand the dynamics of different directions that could go with, different debates that are before the committee, would you be able to talk through some of the consequences of those policies, how they would impact the insurance markets if we did go in a different direction?

Mr. QUARLES. Probably the most concrete is that the European-style capital regulation has made it very difficult for those companies to write annuities, which is a product that is both common in the United States and is really not able to be offered in Europe anymore.

Mr. ZELDIN. Would premiums increase? Would it be more difficult for a working family on Long Island to get auto insurance, homeowners' insurance, or other products to protect their families?

Mr. QUARLES. It could. It is complicated calculations requiring a number of assumptions.

Mr. ZELDIN. And I appreciate that. We are having a debate that happens over the course of multiple hearings, different topics, and it is a good conversation for us to be having, a good debate to be had to flush out the consequences of the policies enacted by this committee.

I am happy that the chairwoman held today's hearing, and I appreciate the time.

I thank the ranking member for his leadership on all of these issues as well, and I yield back.

Chairwoman WATERS. I would like to thank our distinguished witnesses.

Mr. HUIZENGA. Madam Chairwoman, point of inquiry.

Chairwoman WATERS. Yes.

Mr. HUIZENGA. The fact that I am not going to be able to have my 5-minute allotted time apparently, I am curious if this negotiated hard stop was something that was negotiated from the panel, or is this a hard stop for yourself?

Chairwoman WATERS. A stop for the panel. We made the commitment and we are going to keep it. If a mistake was made and you were not notified, we will deal with that later. I would like to thank our distinguished—

Mr. HUIZENGA. Would you, Madam Chairwoman, could I request of our panel that they would at least—

Chairwoman WATERS. —witnesses for their testimony today.

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

The hearing is adjourned.

[Whereupon, at 1:31 p.m., the hearing was adjourned.]

A P P E N D I X

May 16, 2019

NCUA
National Credit Union Administration

Embargoed until Delivery
10:00 a.m.
May 16, 2018

Congressional Testimony

Rodney E. Hood
Chairman
National Credit Union Administration

U. S. House Committee on Financial Services

Hearing on Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions

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NCUA
National Credit Union Administration

Congressional Testimony

Chairwoman Waters, Ranking Member McHenry, 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 provide background on the efforts, activities, objectives, and plans that the NCUA has undertaken and will undertake to fulfill its mission.

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 its paramount responsibilities to regulate and supervise approximately 5,375 federally insured credit unions with more than 116 million member-owners and more than $1.45 trillion in assets across all states and U.S. territories.[3] As an adjunct to that mission, the agency has developed initiatives to make it easier for credit unions to serve their members more effectively, including members of modest means and those in underserved areas.[4]

The first part of my testimony today focuses on the strong state of the credit union industry and the Share Insurance Fund. Next, I will discuss the efforts and initiatives the NCUA has undertaken to meet the goals the agency set out in its *2018–2022 Strategic Plan*: (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.[5] 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 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

[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 December 31, 2018 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 Strategic Plan 2018–2022*, https://www.ncua.gov/files/agenda-items/AG20180125Item3b.pdf.

Fund. I will also address some of the ways the NCUA is promoting financial inclusion and making it easier for credit unions to more effectively serve their members, including the underserved, those of modest means, people with disabilities, and those in vulnerable communities. Finally, I will detail several areas where Congressional action could enhance how the NCUA carries out its safety and soundness mission and allow credit unions to serve their members and communities better, including those of modest means and the underserved.

I. State of the Credit Union Industry and the Share Insurance Fund

Federally insured credit unions continued to perform well in 2018. By year's end, credit union membership grew by more than five million to more than 116 million members. Assets in the credit union system increased to $1.45 trillion, and the system's aggregate net worth ratio stood at 11.30 percent, well above the seven percent statutory level to be considered a well-capitalized credit union.

The NCUA continues to be a responsible steward of agency funds and remains dedicated to sound financial management practices. Through various actions taken by the NCUA Board from 2017 through the present, the agency has increased the strength of the Share Insurance Fund, paid record distributions back to credit unions, and covered the costs of the recent failure of two large credit unions.

Through prudent management, in 2017, the NCUA was able to close the Corporate Credit Union Stabilization Fund (Stabilization Fund) four years ahead of schedule and transfer its assets and obligations to the Share Insurance Fund. This transfer increased the Share Insurance Fund's equity ratio from 1.25 percent to a strong 1.39 percent as of December 31, 2018 — even after reserving for more than $750 million in losses associated with the failure of two relatively large credit unions heavily concentrated in taxi medallion secured lending. This higher equity ratio level positions the Share Insurance Fund to cover expected losses and withstand the impact of a moderate recession without needing to assess credit unions a premium to restore the Share Insurance Fund to its statutory minimum level of 1.20 percent.[6] Because the Stabilization Fund closed early, the NCUA was able to avoid assessing credit unions as much as $1.3 billion in share insurance premiums, while also providing an historic Share Insurance Fund dividend to be paid to credit unions. In July 2018, the NCUA paid a Share Insurance Fund dividend to credit unions of almost $736 million — the largest in its history. Another dividend of $160.1 million will be paid to credit unions in 2019.

At various times throughout 2018, the NCUA was the conservator of six credit unions. As of December 31, 2018, however, no credit unions remained under the NCUA's conservatorship. For 2018, there were eight credit union failures, compared to 10 failures in 2017. The cost to the Share Insurance Fund for insurance losses was $785.0 million in 2018, an increase from $24.4 million in 2017. As discussed above, this

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[6] 12 U.S.C. § 1782(c)(2)(C).

increased cost was largely because of actions needed to address the failure of two large credit unions, each of which was highly concentrated in taxi medallion loans. The NCUA continues to evaluate all courses of action that will maximize potential recoveries from the assets of liquidated credit unions and minimize losses to the Share Insurance Fund. Despite these losses, the Share Insurance Fund remains financially strong and has sufficient equity and reserves to cover anticipated losses.

Despite the strong state of the credit union industry and the Share Insurance Fund, we appreciate the NCUA's duty, as a prudential regulator and insurer, to remain cognizant of the various risks and opportunities posed by the rapidly evolving financial services landscape. Below is a more thorough examination of some of the risks facing the broader economy, including the credit union industry.

Market Risks

As noted above, the credit union system is generally quite strong. There are broader market risks on the horizon, however, that could threaten financial stability generally, including the safety and soundness of the credit union system. For example, rising debt levels may pose some risks to the economy. Corporate debt has increased steadily since 2012,[7] and non-financial debt as a share of the economy is currently at very high levels.[8] A number of factors has driven or facilitated this run-up in borrowing, including share buybacks, low interest rates, and high profits. Since 2012, there has been a particularly sharp increase in the pool of higher-risk debt. The volume of BBB-rated debt, the riskiest tier of investment grade debt, has increased significantly over the last several years.[9] An economic downturn or credit quality downgrades for these lower quality bonds could push them into the speculative grade or "junk" category, which might produce a sell-off in these bonds because some investors are restricted to holding investment-grade debt. A sell-off could limit capital investment and diminish financial stability.

Another market risk is continued uncertainty about the post-Brexit future of the European Union and the United Kingdom.[10] This uncertainty could lead to increased financial market volatility and greater risk aversion, stressing the banking system, causing financial conditions to tighten, and possibly leading to slower economic growth in Europe. Foreign economic activity has already showed signs of slowing and is expected to moderate further over the next year. While experts are not predicting a

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[7] See https://fred.stlouisfed.org/series/NCBDBIQ027S.
[8] See https://www.dallasfed.org/research/economics/2019/0305.aspx; https://www.marketwatch.com/story/these-5-charts-warn-that-the-us-corporate-debt-party-is-getting-out-of-hand-2018-11-29.
[9] See https://www.dallasfed.org/research/economics/2019/0305.aspx.
[10] See https://www.reuters.com/article/britain-rating-moody-s-idINKCN1RN165.

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global recession, a significant deterioration in global economic conditions would have ramifications in international financial markets and the U.S. economy.

Cybersecurity and Technology

Cybersecurity threats and other technology-related issues continue to be of key interest and concern to the NCUA. Cyberattacks pose an acute threat to credit unions, financial regulators, and the broader financial system. Cyber threats such as phishing scams, ransomware, and malware have proliferated in recent years, and financial institutions like credit unions are prime targets. That is why the NCUA again made cybersecurity assessment one of its primary areas of supervisory focus in 2018, and why I will continue to prioritize it as the NCUA's new Chairman.[11] I will make certain that we employ all available resources to ensure data protection for consumers and combat cybersecurity threats.

Last year, the NCUA began implementing a new Automated Cybersecurity Examination Tool, or ACET, to improve and standardize supervision related to cybersecurity.[12] The new examination tool currently is being applied to larger credit unions with over $250 million in assets, but the NCUA continues to test and refine the tool so that we can properly scale it down to apply to smaller, less complex institutions. We believe this will help focus and prioritize cybersecurity for credit unions and make it an integral part of their risk-management strategies.

We also have placed a very strong emphasis on protecting the NCUA from cybersecurity threats and data breaches. The NCUA's Office of the Chief Information Officer is continually taking steps to enhance the agency's information security posture and ensure the NCUA's systems and information are protected from compromise.

Additionally, while technological advances provide credit unions with tremendous opportunities, they also bring new risks. Consumer demand for more modern services and realities about economies of scale have forced many credit unions, particularly smaller ones, to either merge or rely heavily on third-party vendors to enable them to provide those services. As discussed throughout my testimony, the NCUA is working to keep pace with the changes brought by emerging technology and the related threats they pose. In July 2018, the NCUA created Blockchain and Fintech Working Groups to perform an in-depth analysis of financial technology developments, including cryptocurrencies, and their implications for the credit union system. The working groups have been evaluating both the opportunities and risks associated with these new technologies.

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[11] "Supervisory Priorities for 2018," NCUA Letter to Credit Unions, Number 17-CU-09, Dec. 2017, available at https://www.ncua.gov/files/letters-credit-unions/17-CU-09-supervisory-priorities-2018.pdf.
[12] *Id.*

Fintech and credit union reliance on third-party vendors increases systemic cybersecurity risks across the financial services landscape. The credit union system is particularly at risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose.

Currently, the NCUA may only examine credit union service organizations (CUSOs) and third-party vendors with their permission. We cannot enforce any necessary corrective actions or share the results of a voluntary review with customer credit unions of the third-party vendor. In recent years, nearly all of the core technology service providers that exclusively serve credit unions declined a voluntary review by the NCUA. Even though CUSOs are required to give the NCUA access to their books and records, without the NCUA's enforcement authority, the CUSOs are free to reject the NCUA's recommendations to implement the appropriate corrective actions that would mitigate identified risks. This lack of vendor authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators, a situation identified as a concern by both the Government Accountability Office and the Financial Stability Oversight Council (FSOC).[13]

As Chairman, I am committed to working with the NCUA's partners on the FSOC to ensure that various threats to financial markets are properly monitored and mitigated. In March 2019, the FSOC proposed new interpretive guidance on how it would consider designation of nonbank financial companies for enhanced supervision by the Federal Reserve.[14] The guidance calls for the FSOC to focus on an activities-based, or product-based, approach for identifying risks to U.S. financial stability. It would increase the analytical rigor of company determination analyses and ensure that the anticipated benefits of a designation are expected to justify the expected costs. This guidance will increase the FSOC's transparency and will provide the market with much needed clarity on its deliberations. It also ensures that the FSOC is looking at the widest range of potentially problematic financial activities that could threaten market stability.

II. The NCUA's Recent Efforts and Activities

The NCUA's primary mission is to protect the safety and soundness of the credit union system and the Share Insurance Fund. As an adjunct to that mission, the agency has developed initiatives to facilitate credit unions more effectively serving their members and communities, including the underserved and those of modest means. As mentioned, as part of the agency's *2018–2022 Strategic Plan*, the NCUA established

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[13] GAO, Electronic Banking: Enhancing Oversight of Internet Banking Activities, GAO/GGD-99-91 (Washington, D.C.: July 6, 1999). Also, see GAO-04-91 and See U.S. Gov't. Accountability Office, GAO-15-509, Cybersecurity: Bank and Other Depository Regulators Need Better Data and Analytics and Depository Institutions Want More Usable Threat Information 32 (2015), available at https://www.gao.gov/assets/680/671105.pdf.

[14] U.S. Treasury Department, "Financial Stability Oversight Council Proposes Changes to Nonbank Designation Guidance," Mar. 6, 2019, available at https://home.treasury.gov/news/press-releases/sm621.

three goals: (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.[15] Below I will detail the steps the agency is taking to fulfill these missions and achieve these goals.

In meeting the established goals, it is essential that the NCUA Board develops a regulatory environment that meets our safety and soundness mission, but does not unnecessarily inhibit flexibility and innovation within the credit union system and allows credit unions to continue to serve all of their members. As the financial services landscape evolves, the NCUA must evolve with it to promote continued financial stability within the credit union system. In so doing, it is imperative that the agency continues to fulfill its mission in a fully transparent, accountable, and efficient manner. 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 must reduce, streamline, or eliminate 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.

Since 2017, the NCUA has been undergoing a reform and modernization effort. This effort has seen the NCUA reduce the agency's regional structure from five to three regional offices and reorganize several central office functions to reduce costs and increase efficiencies. As part of the agency's broader reform plan, we also undertook a number of actions and initiatives designed to: (1) increase the agency's effectiveness in maintaining the safety and soundness of the credit union system and the Share Insurance Fund; (2) increase the efficiency in our examination, data collection, and reporting efforts; (3) decrease regulatory burdens; (4) increase diversity within the NCUA and the broader credit union industry; and (5) empower credit unions to better serve those of modest means and the underserved.

a. Initiatives Aimed at Increasing Agency Effectiveness in Maintaining Safety and Soundness of the Credit Union System and the Share Insurance Fund

The NCUA has undertaken a variety of initiatives to improve the agency's effectiveness in fulfilling our core mission: protecting the safety and soundness of the credit union system and the Share Insurance Fund. More specifically, in ensuring the success of this mission, the NCUA has: (1) continued to modernize and improve how it conducts examinations of federally insured credit unions; (2) worked to become more proactive in ensuring accountability through enforcement actions against credit union employees and officials engaging in unsafe and unsound practices or fraud; (3) committed to

[15] See *NCUA Strategic Plan 2018-2022*, available at https://www.ncua.gov/files/agenda-items/AG20180125Item3b.pdf.

keeping pace with financial technology developments and the opportunities and risks they pose to credit unions; (4) continued efforts to ensure compliance with consumer protection laws and regulations, the Bank Secrecy Act (BSA), and other applicable laws and regulations; and (5) enhanced transparency surrounding voluntary mergers for the benefit of members. These initiatives complement the NCUA Board's efforts to reduce regulatory, examination, and reporting burdens for federally insured credit unions discussed later.

i. Modernized Examination Considerations

The NCUA has several ongoing initiatives to improve and modernize how the agency conducts its examination and supervision of credit unions. The goals of these initiatives are to streamline processes, adopt enhanced examination techniques, and leverage new technology and data.

Improved Risk Identification Techniques

The NCUA is developing new and advanced risk identification and monitoring capabilities and techniques. These new data and analytical techniques will facilitate more data-driven supervision and enable the agency to better identify and address risk outliers. Additionally, the NCUA incorporated advances in identifying credit unions with an elevated risk of fraud. This further supports the objective to spend less time onsite at low-risk credit unions and leverage technology to maximize efficiency.

Increased Use of Specialists

With the increasing complexity of the financial services landscape, the NCUA has expanded its use of specialists within its examination ranks. We added additional disciplines and subject matter experts to our examination teams to address a broader range of financial products, services, and risks effectively.

Expanded Examiner Training and Guidance

The NCUA recognizes the importance of identifying undue risk exposures timely and relies on both specialized staff and techniques to do so. The agency updated its subject matter examiner training to ensure specialists maintain current knowledge sets and are consistent in the analysis of risk and determination of safety and soundness concerns. The NCUA has also conducted a comprehensive update to its core examiner training. Additionally, the NCUA's *Examiner's Guide* is undergoing an extensive update to expand and clarify risk management expectations for the growing range of financial services credit unions engage in.

Enhanced Examination Quality Control

The NCUA is improving its quality control program to strengthen the examination and supervision process. These improvements will increase our consistency when assessing risk. It will also enable the agency to better identify and address safety and soundness issues.

ii. More Proactive Enforcement

Over the last several years, the NCUA has made a concerted effort to take a more proactive approach to policing the actions of credit union employees and officials through Administrative Orders. As background, Administrative Orders are formal enforcement orders issued by the NCUA pursuant to Section 206 of the Federal Credit Union Act (FCU Act).[16] Generally, the NCUA issues Administrative Orders when it finds that a person affiliated with a credit union has engaged in an unsafe or unsound practice, committed a breach of fiduciary duty, or violated a law, rule, or regulation. The most common orders issued by the NCUA include:

- An **Order to Cease and Desist**, which requires a party to take action (or refrain from taking action), including making restitution; and
- An **Order of Prohibition**, which prohibits a party from ever working for a federally insured financial institution.

The NCUA has increased enforcement staff within the Office of General Counsel and has made efforts to proactively impose administrative sanctions, including Orders of Prohibition, against individuals whose conduct constitutes an unsafe or unsound practice, breach of fiduciary duty, or violation of law, rule, or regulation, but has not yet resulted in criminal charges or a conviction. For a variety of reasons, federal, state, and local law enforcement may opt not to pursue charges against an individual despite their improper conduct. This more proactive approach has allowed the NCUA to remove bad actors from the industry and ensure they do not pose further risk to another federally insured financial institution. In several instances, the NCUA's enhanced investigative and enforcement actions have led law enforcement authorities to file charges and obtain convictions.

The NCUA takes seriously its paramount responsibility to protect the safety and soundness of the credit union industry and the Share Insurance Fund. The agency is committed to supervising the industry to prevent illicit or unsafe or unsound conduct.

iii. NCUA Action Related to Financial Technology and the Credit Union Industry

[16] 12 U.S.C. § 1786.

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Financial technology, or fintech, generally refers to the use of technology to provide financial services in an innovative way. Such services can involve directly serving consumers as well as back office support functions. Some examples of technologies that are upending the delivery of traditional financial services include:

- Peer-to-peer payment systems;
- Artificial intelligence and machine learning that can be used to develop lending models or identify fraud; and
- Blockchain and distributed ledger technologies that can be used for various credit union operations, including payment systems and identity management.

Fintech companies are rapidly changing, and in some cases disrupting, the design and delivery of financial services. Many consumers, businesses, and financial institutions are eager to engage in financial transactions with added convenience and efficiency. Fintech can be developed and offered by financial institutions, third-party vendors, or new entrants into the financial services market. Some fintech companies compete directly with traditional financial institutions, including credit unions, by providing products and services that were once predominantly only available through depository institutions. 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 fintech as their banking counterparts do, while simultaneously clearly understanding and managing any risks they incur. To that end, the NCUA has undertaken several initiatives to address the changing financial services landscape, including:

- In 2018, the NCUA convened two working groups to study these issues: the Fintech Working Group and the Blockchain Working Group.
    - The NCUA's Fintech Working Group is working to identify ways federally insured credit unions can adopt and embrace fintech so they can effectively compete in the changing financial services industry.
    - The NCUA's Blockchain Working Group was established to understand the impact of cryptocurrencies and their underlying distributed ledger technology on the credit union system. The Blockchain Working Group briefed the NCUA Board at the December 2018 open Board meeting and is currently conducting industry outreach efforts.
- Ongoing Monitoring
    - The NCUA is continuing to research and monitor financial technology including online lenders, machine learning, artificial intelligence, and payment systems to identify how they may impact credit unions. The NCUA is interested not only from a competitive standpoint, but also in

how credit unions are partnering with market place lenders and other fintech companies.

Fintech is revolutionizing financial services and the delivery of those services, and consumers are benefiting from increased access to efficient and affordable financial services. It also is requiring traditional financial service providers to adapt and embrace methods, technological innovations, and new technology partners in order to remain competitive in the marketplace. The adoption of many modern technologies requires contractual relationships with third-party vendors. Many fintech companies, however, operate outside of the existing regulatory regime that governs financial institutions, even though most of the key infrastructure vendors (including data processing, payment systems, information technology, lending, and shared branching) have a definite information security and/or anti-money laundering (AML) dimension. Further, fintech increases potential systemic cybersecurity risks across the financial services landscape. The credit union system is particularly vulnerable to this risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose.

Overall, the reduced scrutiny of fintech companies has the potential to present an uneven playing field between them and traditional financial institutions. In addition, without clear-cut oversight from federal regulators, the NCUA has concerns about the risks fintechs could pose to credit union members, the Share Insurance Fund, and the stability of the broader financial system. To help address concerns about regulatory arbitrage, the NCUA is also actively coordinating its supervisory efforts with the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Additionally, the NCUA is participating in the following interagency initiatives:

- Interagency Fintech Discussion Forum—This forum, convened by the Board of Governors of the Federal Reserve, provides an opportunity for senior-level representatives to discuss each agency's actions related to fintech and identify opportunities for collaboration, specifically related to consumer protections.
- Mobile Payments Industry Working (MPIW) Group—The NCUA participates in the MPIW Group, which meets regularly to consider potential resolutions for shared issues and the elimination of barriers to adoption of retail mobile or digital payments.
- Federal Financial Institutions Examination Council (FFIEC) Task Force on Supervision (TFOS)—The TFOS coordinates and oversees matters relating to safety-and-soundness supervision and examination of depository institutions. It provides a forum for Council members to promote quality, consistency, and effectiveness in examination and other supervisory practices. While significant

issues and recommendations are referred to the Council for consideration and action, the Council has delegated to the TFOS the authority to make certain decisions and recommendations, provided that no TFOS member dissents or requests review by the Council. Meetings are held monthly to address and resolve common supervisory issues. The TFOS also maintains supervisory communication protocols to be used in emergencies. These protocols, established by the TFOS, are periodically tested through exercises with TFOS members and key supervisory personnel.

- FFIEC Task Force on Consumer Compliance—The Task Force on Consumer Compliance (TFCC) promotes policy coordination, a common supervisory approach, and uniform enforcement of consumer protection laws and regulations. The TFCC identifies and analyzes emerging consumer compliance issues and develops proposed policies and procedures to foster consistency among the agencies. Additionally, the TFCC reviews legislation, regulations, and policies at the state and federal level that may have a bearing on the consumer compliance supervision responsibilities of the member agencies.

iv. Ensuring Compliance with Consumer Protection Laws and Regulations, the Bank Secrecy Act, and other Applicable Laws and Regulations

Ensuring Compliance with Consumer Protection Laws and Regulations

The NCUA performs annual targeted reviews for compliance with various consumer financial protection regulations during the agency's safety and soundness examinations of federal credit unions. Additionally, in 2018, the NCUA's Office of Consumer Financial Protection spent over 4,700 hours examining credit unions for compliance with fair lending laws and regulations. In addition, agency staff spent approximately 1,000 hours performing offsite supervision contacts to review credit unions' loan policies and, if necessary, provide recommendations to bring them into compliance with fair lending laws. The Consumer Assistance Center is another critical part of the NCUA's enforcement of consumer financial protection laws and regulations. It receives and handles consumer complaints and does its own investigation to determine compliance with applicable federal consumer financial protection laws and regulations. During the year, the Consumer Assistance Center assisted 53,337 consumers, up from 52,635 in 2017, and recorded more than $822,000 in monetary benefits for complainants.[17]

[17] This figure includes restitution by the credit union, relief from an alleged monetary obligation imposed by the credit union, and access to disputed credit or financial services products otherwise not available to the member by the credit union.

Additionally, the NCUA participates on the FFIEC's Task Force on Consumer Compliance, which promotes policy coordination, a common supervisory approach, and uniform enforcement of consumer protection laws and regulations.

Ensuring Compliance with the Bank Secrecy Act

The NCUA takes seriously its obligations to supervise federal credit unions for compliance with the various BSA and AML laws and regulations. As technology has become embedded in financial systems, even small financial institutions like credit unions can be vulnerable to illicit finance activity. The NCUA examines federal credit union compliance with BSA during every examination that we conduct. Additionally, the NCUA assists state regulators by conducting BSA examinations in federally insured, state-chartered credit unions where state resources are limited. In 2018, the NCUA conducted 3,308 BSA examinations in federal credit unions.

The NCUA's BSA reviews are risk-focused and include a set of core procedures that cover an institution's compliance with the pillars of the BSA. These core procedures are based on the FFIEC examination procedures we issue jointly with the other federal financial regulatory agencies. In addition to the core procedures, examiners are trained and directed to tailor examinations based on the unique risk characteristics of each federal credit union. Federal credit unions that have diverse platforms with higher risk activities will receive an expanded review tailored to the unique risk characteristics they present. Conversely, examinations of smaller, low-risk credit unions are appropriately scaled to minimal necessary procedures consistent with their risk characteristics and our obligations under the FCU Act.

The NCUA coordinates regularly with our counterparts as the other federal financial regulatory agencies, as well as the Financial Crimes Enforcement Network (FinCEN). The NCUA actively participates in the Bank Secrecy Act Advisory Group (BSAAG) and the FFIEC BSA Working Group. Additionally, the NCUA is part of a recently established interagency working group to improve effectiveness and streamline, where possible, our regulations and supervisory processes. The working group recently issued a Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing,[18] as well as an Interagency Statement on Shared BSA Resources.[19] Both joint statements provide appropriate information for institutions to leverage resources and new technologies to improve and streamline their BSA compliance obligations. The NCUA intends to continue to foster collaborative working relationships with our regulatory counterparts, including FinCEN. I believe that this is especially important in

[18] The statement can be found at https://www.ncua.gov/files/press-releases-news/joint-statement-bsa-innovation.pdf.

[19] The statement can be found at https://www.ncua.gov/newsroom/press-release/2018/agencies-issue-joint-statement-encourage-innovative-approaches-bsaaml-compliance.

addressing substantial concerns related to the proliferation of cash-based businesses, which further necessitates reforming and modernizing the BSA regime.

Finally, the NCUA also communicates with the credit union industry through numerous channels, including: BSAAG participation and outreach; assistance and participation in national events applicable to the BSA attended by credit union industry professionals and leaders; and through periodic and ongoing training via webinars. The NCUA continues to maintain transparency in its policy positions. To that end, the agency publishes our examination and policy manuals, as well as nearly all guidance and directives provided to examiners related to the supervisory process or examinations.[20]

v. Enhancing Transparency Surrounding Voluntary Mergers

The NCUA Board recently adopted changes to the agency's voluntary mergers regulation designed to increase transparency and member engagement.[21] As background, the FCU Act requires the NCUA Board's "prior written approval" for any merger or consolidation between insured credit unions.[22] In granting or withholding this approval, the FCU Act requires the Board to consider six factors, which are:

1. The history, financial condition, and management policies of the credit union;
2. The adequacy of the credit union's reserves;
3. The economic advisability of the transaction;
4. The general character and fitness of the credit union's management;
5. The convenience and needs of the members to be served by the credit union; and
6. Whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.[23]

These factors are broader than safety and soundness and require the NCUA to consider the effect of the proposed merger on credit union members. The NCUA's merger regulation ensures that consideration of member interests by requiring a member vote on the proposed merger in addition to the NCUA's oversight.

Under the revised merger rule, members of a credit union whose board has voted to merge must receive notice at least 45 days before the vote, and have an opportunity to

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[20] Some examiner guidance is kept confidential, such as fraud detection techniques, in order to maintain their integrity and effectiveness.
[21] 83 Fed. Reg. 30301 (June 28, 2018).
[22] 12 U.S.C. § 1785(b)(3).
[23] *Id.* § 1785(c).

submit comments about the proposed merger for posting on a section of the NCUA's website where other members can view the comments. The revised regulation also more clearly articulates the required content and format of the member notice to ensure that credit union members have all relevant information about the proposed merger, including merger-related financial incentives for staff or officials. The revised rule applies to all insured credit unions, whether state or federally chartered. The NCUA's Regional Offices review merger application packages and member notices to ensure compliance with the regulation before the members vote.

The FCU Act also requires the NCUA Board's prior approval for most transactions between insured credit unions and other institutions,[24] and directs the NCUA to oversee the methods and procedures of the member vote when an insured credit union proposes to convert to a mutual savings bank.[25] The NCUA has adopted regulations addressing credit union conversions to banks, mergers into banks, and mergers with privately insured credit unions, all of which provide for member votes.[26] The NCUA is also aware that the number of transactions where an insured credit union has acquired a bank or portions of a bank have been increasing. Currently, the NCUA addresses these types of transactions on a case-by-case basis. The NCUA's oversight of these transactions focuses on ensuring that insured credit unions retain only permissible assets and that former bank customers receive all the rights and privileges of credit union membership when such transactions close.

b. Initiatives Aimed at Increasing Agency Efficiency and Reducing Examination and Reporting Burdens

The NCUA continues to improve the regulatory environment for credit unions without sacrificing our safety and soundness mission. Pursuant to its reform and modernization efforts, the agency has reduced its regional structure from five to three regional offices and reorganized several central office functions to reduce costs and increase efficiencies.

As part of the agency's reform efforts, the NCUA has also undertaken a number of initiatives to increase the efficiency in our examination, data collection, and reporting efforts. Specifically, I call your attention to the following three programs:

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[24] 12 U.S.C. § 1785(b)(1).
[25] *Id* § 1785(b)(2)(G)(ii).
[26] 12 CFR §§ 708a, 708b.

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Exam Flexibility Initiative[27]

This initiative provides greater examination efficiency and flexibility for credit unions and the agency, and improves coordination with state supervisors. Because of this initiative, the NCUA adjusted the frequency of examinations based on a credit union's size, complexity, operating condition, and, in the case of state-chartered credit unions, the frequency of state examinations. This initiative resulted in meaningful regulatory relief for the vast majority of credit unions, led to greater coordination between federal and state regulators, and allowed the NCUA to focus more efforts on troubled credit unions, with the anticipated benefit of addressing some problems earlier when they are easier and less costly to resolve.

The Enterprise Solution Modernization Program[28]

This multi-year program modernizes the NCUA's technology infrastructure to create an integrated examination and data environment, and further enhances the agency's cybersecurity posture. It incorporates emerging technology solutions that support the NCUA's examination, data collection, and reporting efforts to improve key, integrated business processes and meet applicable security protocols. The program will improve the examination process and ease burdens on credit unions and staff by reducing the amount of examination and supervision time spent onsite in credit unions. The NCUA expects an improved user experience and increased efficiencies when the new systems are in place.

The Call Report Modernization Project[29]

This project complements the Enterprise Solution Modernization Program and involves a comprehensive review of Call Report and Credit Union Profile data content.[30] The NCUA developed a prototype Call Report and Profile that eliminated outdated fields and simplified the reporting process without sacrificing important information necessary for proper supervision and data analyses. In order to ensure a transparent and collaborative process, the agency solicited public comment on the prototype. The NCUA estimates the proposed changes will reduce the number of account codes collected from credit unions. If the proposal is adopted, the agency will revise and

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[27] See NCUA Exam Flexibility Initiative, https://www.ncua.gov/About/Pages/open-government/exam-flexibility-initiative.aspx.
[28] See NCUA Enterprise Solution Modernization (ESM) Program, https://www.ncua.gov/About/Pages/open-government/enterprise-solution-modernization-program.aspx.
[29] See NCUA Call Report Modernization, https://www.ncua.gov/About/Pages/open-government/call-report-modernization.aspx.
[30] The NCUA uses the Call Report and Profile to collect financial and nonfinancial information from federally insured credit unions. The resulting data are integral to risk supervision at institution and industry levels, which is central to safeguarding the integrity of the Share Insurance Fund.

improve its Call Report schedules and instructions to make it easier for credit unions to complete this critical regulatory filing.

c. Initiatives Aimed at Decreasing Regulatory Burdens

My longstanding regulatory philosophy is that regulation needs to be effective, but not excessive. Consistent with the spirit of President Trump's regulatory reform agenda and Executive Order 13777, the NCUA established a Regulatory Reform Task Force to oversee the implementation of the agency's own regulatory reform agenda. Although the NCUA, as an independent regulatory agency, is not required to comply with Executive Order 13777, the agency chose to comply with its spirit by undertaking a comprehensive review of all of the NCUA's regulations. Beginning in 2017, the Regulatory Reform Task Force began reviewing the agency's rules with an eye towards creating a transparent and fully accountable regulatory framework that acknowledges the need for flexibility, creates new avenues for growth, and strengthens the system's resiliency, while simultaneously reducing the regulatory burden where prudent and appropriate.

The Regulatory Reform Task Force published the NCUA's first report for public comment in August 2017.[31] This reform agenda proposed a four-year, three-tiered regulatory relief plan with approximately 40 regulatory relief recommendations. After reviewing and considering the comments received, the Task Force issued its second and final report in December 2018.[32] This second report provided an updated blueprint for the agency's regulatory reform agenda and a formal means of measuring the agency's regulatory relief efforts moving forward.[33]

To date, the NCUA has completed twelve of the reports' regulatory relief recommendations and proposed rules or commenced action on seven others. Specifically, the NCUA issued final regulations or took other final actions designed to:

- Provide additional flexibility to corporate credit unions' capital standards;[34]
- Improve the NCUA's emergency merger process;[35]

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[31] 82 FR 39702 (Aug. 22, 2017), available at https://www.ncua.gov/About/Pages/board-actions/comments/Documents/regulatory-review-notice-2017.pdf.
[32] 83 FR 65926 (Dec. 21, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-12-21/pdf/2018-27473.pdf. A consolidated version of the final report is available at https://www.ncua.gov/files/agenda-items/AG20181213Item1b.pdf.
[33] See Implementation of the NCUA's Regulatory Reform Agenda, available at https://www.ncua.gov/regulation-supervision/rules-regulations/regulatory-reform-agenda/implementation-ncuas-regulatory-reform-agenda.
[34] 82 FR 55497 (Nov. 22, 2017).
[35] 82 FR 60283 (Dec. 20, 2017).

- Recognize that federal credit unions may securitize the loans they make;[36]
- Improve the NCUA's appeals process for examination determinations to ensure due process and fairness;[37]
- Improve and centralize the NCUA's appeals procedures in one section of the NCUA's regulations;[38]
- Provide greater transparency regarding the calculation of each eligible financial institution's pro rata share of a declared equity distribution from the Share Insurance Fund;[39]
- Decrease the burden and improve the efficiency of the NCUA's capital planning and stress testing rules;[40]
- Decrease burden and add flexibility to the NCUA's advertising requirements;[41]
- Add flexibility to the NCUA's field-of-membership processes;[42]
- Make clarifying and technical changes to improve the user-friendliness of the NCUA's loan maturities requirements;[43]
- Clarify the NCUA's limits on loans to a single borrower or group of associated borrowers;[44] and
- Delay the effective date of the NCUA's risk-based capital rule and decrease the number of credit unions covered by the rule.[45]

Additionally, the NCUA proposed or sought advanced comment on amendments that would provide regulatory relief by:

- Permitting federal credit unions the ability to provide an additional market-based alternative to payday loans;[46]
- Improving the NCUA's regulations governing federal credit union bylaws;[47]
- Improving the NCUA's appraisals regulation to reduce burden and make compliance easier.[48]
- Improving the NCUA's regulations governing fidelity bond for credit unions;[49]

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[36] Asset Securitization Authority, NCUA OGC Op. Ltr. 17-0670 (June 21, 2017), available at https://www.ncua.gov/regulation-supervision/Pages/rules/legal-opinions/2017/asset-securitization-authority.pdf; and 82 FR 29699 (June 30, 2017).
[37] 82 FR 50270 (Oct. 30, 2017).
[38] 82 FR 50288 (Oct. 30, 2017).
[39] 83 FR 7954 (Feb. 23, 2018).
[40] 83 FR 17901 (Apr. 25, 2018).
[41] 83 FR 17910 (Apr. 25, 2018).
[42] 83 FR 30289 (June 28, 2018).
[43] 84 FR 10971 (Mar. 25, 2019).
[44] *Id.*
[45] 83 FR 55467 (Nov. 6, 2018).
[46] 83 FR 25583 (June 4, 2018).
[47] 83 FR 56640 (Nov. 13, 2018).
[48] 83 FR 49857 (Oct. 3, 2018).
[49] 83 FR 59318 (Nov. 23, 2018).

- Simplifying and clarifying the audit process required by the NCUA's regulations by replacing the current highly prescriptive standard to comply with the Supervisory Committee Guide with minimum procedures to be included in an audit;[50]
- Providing flexibility on the NCUA's regulations regarding the timing of a compensated auditor delivering the written annual audit report to the credit union;[51] and
- Seeking advanced comment on how to enhance the clarity of, and potentially provide greater flexibility to, the NCUA's requirements governing compensation for credit union employees and officials in connection with loans to members.[52] These requirements are separate from the interagency action undertaken by the NCUA and various other regulators related to the incentive compensation requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).[53] The agencies continue to work on these incentive compensation requirements in order to resolve outstanding issues and move forward with further action.

With the Regulatory Reform Task Force's review of the NCUA's regulations complete and its recommendations in the process of being implemented, the NCUA has reinstituted its annual regulatory review to provide stakeholders with an ongoing means of providing feedback on the NCUA's regulations. As part of this process, the agency reviews and solicits public comment on one-third of the agency's regulations each year. Agency staff then provides the NCUA Board with regulatory recommendations, based in part on the comments received. The NCUA opened the comment period for the first one-third of its regulations in January 2019.[54]

Separately, I would also like to emphasize that, as the NCUA's new Chairman, it is a priority of mine to ensure that the NCUA's regulations governing risk and capital are appropriately harmonized. Risk and capital are the underpinnings of a safe and sound credit union system and need to work in concert. Capital requirements must be properly tailored to ensure that credit unions are holding levels of capital that are appropriate for

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[50] 84 FR 5957 (Feb. 25, 2019).
[51] *Id.*
[52] 84 FR 16796 (Apr. 23, 2019).
[53] In 2011, the NCUA joined with six other federal financial regulators to issue a proposed rule implementing Section 956 of the Dodd-Frank Act. The agencies issued a revised proposed rule in 2016. The 2016 proposed rule would require federally insured credit unions with assets of $1 billion or more to provide the NCUA with information about the structure of future incentive-based executive compensation programs. The joint agency rulemaking would prohibit incentive-based compensation payment arrangements in financial institutions with $1 billion or more in assets that the agencies determine would encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss.
[54] See Regulatory Review, https://www.ncua.gov/regulation-supervision/rules-regulations/regulatory-review.

and commensurate with their individual risk profiles. I will do my level best to ensure that the NCUA's requirements properly balance risk and capital to ensure a credit union system that is both safe and sound and allows for maximum efficiency.

d. Diversity and Inclusion at the NCUA and in the Credit Union Industry

The NCUA has worked hard to encourage diversity and inclusion both within the agency and the broader credit union industry. Below is a summary of the NCUA's diversity and inclusion activities and efforts related to implementation of Section 342 of the Dodd-Frank Act and compliance with Section 308 of Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), as amended by the Dodd-Frank Act, as it relates to minority depository institutions (MDIs).

i. The NCUA's Implementation of Section 342 of the Dodd-Frank Act

Assessing the Diversity Policies and Practices of Entities Regulated by the Agency

Pursuant to Section 342(b)(2)(C) of the Dodd-Frank Act, credit unions and other financial institutions, especially those with more than 100 employees, are encouraged to conduct annual self-assessments of diversity and inclusion practices and policies related to workforce and contracting activities. To facilitate the self-assessment process, the federal financial regulatory agencies collectively established the diversity standards set forth in the 2015 Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices.[55] The joint standards are grouped into these five areas, or sets of standards:

1. Organizational commitment to diversity and inclusion;
2. Workforce profile and employment practices;
3. Procurement and business practices (supplier diversity);
4. Practices to promote transparency; and
5. Entities' self-assessment.

The standards provide a framework for a financial institution to create or strengthen its diversity policies and practices. Using these joint standards, the NCUA created the *Annual Voluntary Credit Union Diversity Self-Assessment* tool, tailored for credit unions, that provides guidance for advancing diversity and inclusion.[56] It also highlights best practices for demonstrating a commitment to diversity and inclusion. Credit unions began conducting and submitting self-assessments voluntarily to the

[55] 80 FR 33016 (June 10, 2015).
[56] Annual Voluntary Credit Union Diversity Self-Assessment, available at https://cudiversity.ncua.gov/.

NCUA's Office of Minority and Women Inclusion (OMWI) in 2016. The NCUA uses the aggregated self-assessment data to monitor progress and trends in credit union diversity-related activities. OMWI only shares the results anonymously, primarily in the NCUA's annual *OMWI Report to Congress* and in an annual report of the self-assessment results. The first of these reports is the *2017 Credit Union Diversity Self-Assessment Results Report* issued in 2018.

The self-assessment data also informs the NCUA of areas where additional guidance could be useful. When appropriate, the NCUA issues such guidance to assist credit unions with their diversity efforts. In 2018, the NCUA issued a *Credit Union Guide to Supplier Diversity* after identifying that many credit unions reported low levels of engagement in this area. The NCUA's OMWI also participates in credit union industry and league conferences promoting the benefits of conducting the self-assessment and the value of diversity and inclusion for credit unions.

Inclusion in all Levels of Business Activities

Section 342(c) of the Dodd-Frank Act directs each OMWI Director to "develop and implement standards and procedures to ensure, to the maximum extent possible, the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activities of the agency at all levels, including in procurement, insurance, and all types of contracts." When the NCUA first began tracking the participation of minority- and women-owned businesses in the agency's contracting opportunities in 2011, minority- and women-owned businesses represented 6 percent of the agency's vendors. Since implementing procurement guidance that promoted the inclusion of one-third minority- and women-owned businesses of all invited vendors, the agency has made consistent progress year after year. The agency achieved 45 percent minority- and women-owned business participation in its 2018 contracts.

Diversity in the Agency's Workforce

Section 342(f) of the Dodd-Frank Act directs each agency to "take affirmative steps to seek diversity in the workforce of the agency at all levels of the agency in a manner consistent with applicable law."

The NCUA has made progress toward greater diversity in its workforce. Over the last four years, the minority representation has improved each year, increasing from 26.32 percent to 29.74 percent over that period. The percentage of women and minorities at the executive level also has improved each year. Female representation in the executive ranks grew from 41.2 percent to 45.3 percent, while minority representation increased from 11.8 percent to 18.9 percent.

The NCUA has also implemented the following as part of our organizational diversity and inclusion efforts:

- Included diversity and inclusion as a strategic objective in agency strategic plan;
- Developed a five-year diversity and inclusion plan;
- Established a diversity advisory council;
- Provided annual diversity and inclusion training;
- Established a mentoring program;
- Maintained a student intern program;
- Participated in targeted diverse recruitment;
- Established a policy to use diverse interview panels when possible;
- Used structured interviews in examiner and senior staff interviews;
- Conducted annual adverse impact analysis on principal examiner testing;
- Provided unconscious bias training for all staff and additional training for managers;
- Included a diversity and inclusion element in all supervisor performance plans;
- Provided special emphasis programs for the following groups;
    - African American
    - Women
    - Asian
    - LGBTQ
    - Hispanic
    - Disability
    - Veterans
    - Native American
- Held monthly diversity discussions;
- Issued monthly diversity newsletters;
- Resurveyed the workforce to update disability status;
- Established employee resource groups; and
- Released annual policy statements from the NCUA Chairman reinforcing commitment to equal opportunity employment and diversity and inclusion in the agency's workforce, workplaces, and business practices.

ii. The NCUA's Compliance with Section 308 of FIRREA as it Relates to MDIs

Minority depository institutions, or MDIs, play a crucial role in providing affordable financial services in areas that have been largely unserved or underserved by the traditional banking system. MDIs often are the only federally insured financial institutions in these areas.

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MDIs-at-a-Glance[57]

- 529 federally insured credit unions are designated as MDIs.
- MDIs are located throughout 37 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Texas, California, New York, Hawaii, Illinois, and Louisiana have the highest number of MDIs.
- Collectively, MDIs serve 3.9 million members and manage $38.5 billion in assets. Texas, by far, has the highest number of members with more than 1.5 million followed by Hawaii, California, Maryland, and New Mexico. Hawaii, California, Maryland, New Mexico, the District of Columbia, and North Carolina, each have more-than $1 billion in aggregate MDI assets.

The NCUA's MDI Preservation Program

A federally insured credit union may self-designate as an MDI through the NCUA's Credit Union Online Profile. The credit union must affirm that more than 50 percent of its current members, eligible potential members, and board of directors are from one of the four minority categories specified under the law. The NCUA relies on the definition of "minority" in Section 308 of FIRREA, which identifies an eligible minority exclusively as any Asian American, Black American, Hispanic American, or Native American.

The NCUA's most recent actions to preserve and promote MDIs include:

1. *Preserving the present number of MDIs*

The NCUA's MDI Preservation Program is designed to provide needed support to credit unions that serve communities and individuals who may lack access to mainstream financial products and services. The NCUA's examination staff work directly with credit unions on this program and the NCUA's Office of Credit Union Resources and Expansion (CURE) provides several support services.[58]

- **Field of Membership Expansion:** During 2018, the NCUA approved the chartering and field of membership expansions for 28 MDIs These approvals allowed the credit unions to add, in aggregate, more than 650 groups or

[57] Based on the Call Reports and Credit Union Online Profiles as of Dec. 31, 2018.
[58] CURE assumed responsibility for administering the NCUA's MDI Preservation Program in January 2018, as part of an agency-wide restructure. Prior to that, the program was administered by the NCUA's OMWI. CURE fosters credit union development by offering support services to all credit unions. The resources particularly appeal to small and low-income designated credit unions and MDIs, and include: chartering and field of membership activities; grant and loan programs; the MDI Preservation Program; and training services.

expanded geographic areas to their memberships.[59]

- **Increasing the Number of MDIs:** During 2018, the NCUA launched a social media campaign to identify new MDIs. The campaign coincided with Minority Enterprise Development Week.[60]
- **Direct Feedback from MDIs:** The NCUA surveyed MDIs about the challenges of serving their members. Chief executive officers, managers, board members, and staff of MDIs responded to the survey, which was designed to ensure the agency's services are responsive to the needs of the credit unions consistent with Section 308 of FIRREA.[61]

2. ***Preserving their minority character in cases of merger or acquisition of a MDI***

During 2018, 21 MDIs merged into other credit unions. Five of the continuing credit unions, 24 percent, were MDIs. MDI mergers represented 12 percent of all mergers of federally insured credit unions during 2018.[62] In most cases, the NCUA's examination staff work directly with a credit union providing guidance to the board and management throughout a merger.

3. ***Providing technical assistance to undercapitalized credit unions***

When a credit union becomes undercapitalized, it is required to develop a net worth restoration plan, subject to the NCUA's approval. The NCUA assists MDIs that are undercapitalized and subject to prompt correction action in developing these net worth restoration plans. Both CURE and examination staff work with credit unions in this area with the goal of restoring the credit union to an acceptable level of capital.

4. ***Promoting and encouraging the creation of new MDIs***

CURE now administers the chartering of new credit unions. This was a key component of the recent agency-wide realignment. The realignment now makes it easier to coordinate the agency's work to encourage new credit unions, including MDIs. As detailed later in my testimony, one of my top priorities as the NCUA's new Chairman is enhancing and modernizing the federal credit union chartering process. It is my belief

[59] A credit union's field of membership represents the legal definition of who is eligible to join. A federally chartered credit union must receive approval from the NCUA prior to changing its field of membership. Excerpt from "Field-of-Membership Expansion," Support Services section of the NCUA website, April 1, 2019.
[60] Minority Enterprise Development Week is a commemoration sponsored, in part, by the Minority Business Development Agency of the U.S. Department of Commerce.
[61] The results of this survey were qualitative in nature and are not generalizable to the population of the study.
[62] There were 34 fewer MDI credit unions at December 31, 2018 than at the end of the prior year. Mergers accounted for 62 percent of the decrease in the number of MDIs.

that enhancing and modernizing the federal credit union chartering process will encourage the creation of MDIs and promote greater financial inclusion.

5. ***Providing funding, technical assistance, training and educational programs***

- **Funding:** Through its Community Development Revolving Loan Fund, the NCUA awarded 31 grants totaling $284,200 to MDIs during 2018. This fund is unique among federal depository regulators and provides loans and grants to low-income credit unions as designated by the NCUA. These grants will assist the credit unions in their ability to provide financial products and services to approximately 133,850 members in aggregate, the majority of whom are minorities. Nine of the credit unions, almost 30 percent, were first-time recipients of the grant; 87 percent were small credit unions with assets below $100 million.

- **Technical Assistance:** The NCUA qualified six MDIs through the NCUA-CDFI Certification Initiative during 2018. The Initiative began in 2016 between the NCUA and the U.S. Department of the Treasury's Community Development Financial Institutions (CDFI) Fund.[63] The initiative streamlines the qualification and application processes for low-income credit unions that qualify to be certified as a CDFI. The NCUA leverages existing data and processes the agency has as the primary regulator of federally insured credit unions. Once the NCUA determines a credit union qualifies for the streamlined application, it provides the credit union with information necessary to complete and submit a certification application to the CDFI Fund. The application requires less data and independent analysis than the traditional process. The CDFI Fund has the sole authority to determine an applicant's certification status.[64]

  Having the CDFI certification affords such organizations access to a variety of funding programs through the CDFI Fund. Such funding can enable a credit union to finance a range of activities, such as mortgage lending for first-time homebuyers and commercial loans.

- **Training and Educational Programs:** Training for credit union management, board members and staff can significantly influence the success of an MDI. This year, the NCUA will offer training targeted to MDIs on financial

[63] Joint Initiative Press Release: https://www.ncua.gov/newsroom/Pages/news-2016-jan-community-development-financial-institutions.aspx.
[64] CDFI certification is the U.S. Department of the Treasury's recognition of specialized financial institutions serving low-income and economically disadvantaged communities. CDFI Certification Eligibility Requirements: https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx.

analysis/statement analysis and board of director responsibilities. During 2018, the agency updated its Learning Management Service, which provides online access to a variety of training topics such as credit union governance, operations, and products and services. The service offers on-demand learning opportunities and is available free of charge to all credit unions.

In March, the NCUA launched an educational series of semi-annual conference calls featuring topics of interest to MDIs. The first call entitled, "An Introduction to CURE," provided an overview of the office and the services it offers to MDIs. The next call will occur during the third quarter of 2019.

e. Initiatives Aimed at Empowering Credit Unions to Better Serve the Underserved

America's credit unions are on the frontline of providing affordable access and opportunity to the financial system. Credit unions play a critical role in helping families achieve the American dream of homeownership, assisting entrepreneurs in creating small businesses, and providing the trusted affordable and essential financial services so families can save for the future.

Promoting financial inclusion and shared prosperity in underserved communities is a priority of mine. I still fondly remember the joy and excitement I saw when a young woman who attended one of my bank's homebuyer education classes learned that homeownership was not just a dream for her and her family. She was able to attend a series of homebuyer classes, build a credit profile and obtain down-payment assistance to purchase her first home. She showed her appreciation by inviting me to tour her new home and share a meal with her family.

As described below, the NCUA has developed initiatives to help create opportunities to promote financial education and financial inclusion, and foster an environment where the low-to-moderate income, people with disabilities, and the otherwise underserved have access to affordable financial services.

<u>Payday Alternative Loans</u>

There continues to be persistent demand for short-term, small dollar loans. To provide credit union members with a safe and less expensive alternative to high-cost, traditional payday loans, the NCUA's regulations permit federal credit unions to offer small-dollar loans called payday alternative loans (PALs).[65] As of the end of 2018, 502 federal credit unions reported that they made PALs loans during the year. These credit unions reported making 211,574 loans amounting to $145.2 million in PALs during the year.

[65] 12 CFR 701.21(c)(7)(iii).

In comparison, in 2012, 476 federal credit unions reported that they made 115,809 loans amounting to $72.6 million of lending during the year.[66]

Credit unions can present consumers with a viable alternative to predatory lenders. In June 2018, the NCUA Board proposed amendments to the NCUA's PALs regulation to provide federal credit unions with an additional payday alternative loan option.[67] The new proposed payday alternative loan option (PALs II) would not replace the current payday alternative loan program (PALs I), but would serve as an additional market-based alternative. The proposed PALs II option has features to enable federal credit unions to meet the needs of certain borrowers not met by the current program and encourage additional federal credit unions to offer PALs.

The NCUA Board also sought public comment on a possible third option (PALs III), asking, in particular, for feedback on interest rates, maximum loan amounts, loan terms, and application fees.

Expanding Access to Affordable Financial Services

Small credit unions, low-income designated credit unions, and MDIs play a critical role in providing affordable financial services to millions of Americans. Often, these credit unions are the only federally insured financial institutions in underserved and rural communities. Yet, they face the challenges of increased competition, stagnant membership, and lagging earnings.

A critical component of NCUA's efforts to support these credit unions is the low-income designation. To qualify as a low-income designated credit union, a majority of a credit union's membership must meet certain low-income thresholds based on data available from the American Community Survey taken by the U.S. Census Bureau.

There are several benefits for credit unions that carry a low-income designation, including:

- An exemption from the statutory cap on member business lending, which expands access to capital for small businesses and helps credit unions diversify their portfolios;
- Eligibility for grants and low-interest loans from the Community Development Revolving Loan Fund;
- Ability to accept deposits from non-members; and
- An authorization to obtain secondary capital.

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[66] 83 FR 25583 (June 4, 2018).
[67] *Id.*

In 2018, the NCUA approved 18 community-charter conversions, the expansion of 53 existing community charters, and 16 expansions into underserved areas. The agency also approved the addition of 9,732 groups to the fields of membership of multiple common-bond credit unions.
The NCUA also issued one new federal credit union charter in 2018 to Everest Federal Credit Union in Jackson Heights, New York.

While I appreciate the agency's hard work in this area, one of my top priorities as the NCUA's new Chairman is enhancing and modernizing the federal credit union chartering process. The current processes for the de novo chartering, conversion, and expansion of federal credit unions is burdensome and time-consuming. I have directed staff to find meaningful ways to reduce the amount of time and the hurdles to chartering a new credit union. It is my belief that enhancing and modernizing the federal credit union chartering process to help individuals better understand the value of the federal credit union charter will encourage and enable the credit union system to better serve vulnerable communities, promote greater financial inclusion, and bring more people into the economic mainstream.

In this vein, next week, I will have the honor of presenting a new federal credit union charter that will serve a Native American community. This low-income credit union will provide much needed financial services to individuals and businesses in one of our nation's most underserved areas. This is just one example of credit unions doing what they can to help residents of rural areas and tribal lands, many of whom are unbanked or underbanked. Through their mission to serve the underserved, credit unions, such as the newly chartered one that I will visit next week, can help to ensure that those in rural areas and on tribal lands receive adequate financing for home loans and new housing construction in these areas. I am excited to continue working with my fellow Board Members and agency staff to explore all avenues within the NCUA's authority to increase access for unbanked and underbanked individuals to credit union products and services, including building upon the NCUA's already impressive financial literacy efforts.

<u>Empowering Consumers with Information to Make Independent and Informed Financial Decisions</u>

While credit unions serve the needs of their members and promote financial capability within the communities they serve, the NCUA reinforces credit union efforts, and raises consumer awareness about the importance of saving and having a strong understanding of the concepts of financial literacy and personal finance.

The NCUA participated in 41 events, meetings, and conferences in 2018 reaching educators, financial literacy professionals, credit union officials, non-profit leaders, and other stakeholders. The NCUA also participated in national financial literacy

initiatives, including the Financial Literacy and Education Commission, an interagency group created by Congress to improve the nation's financial literacy and education.

In December 2018, the NCUA launched an updated version of its consumer website, MyCreditUnion.gov, featuring a mobile responsive design, enhanced search functions, and improved navigation for easy access to consumer financial protection and financial literacy topics. By the end of the year, the English and Spanish-language versions of MyCreditUnion.gov had 865,195 visits, up 14.8 percent from 753,588 visits in 2017.

As discussed in greater detail below, there are a number of areas where Congressional action can help credit unions better serve the underserved and those of modest means.

III. Potential Areas for Beneficial Congressional Action

While the NCUA Board does its best to provide federally insured credit unions with meaningful regulatory relief to enhance credit union operations and encourage better service of those of modest means and the underserved, Congressional action can provide additional flexibility in some areas. Today, I would like to highlight three areas where Congressional action can provide new avenues for credit union growth and enhanced service, without sacrificing the safety and soundness of the credit union system. These include modifying the FCU Act's provisions related to field of membership, providing the NCUA Board the authority to set maximum loan maturities by regulation that exceed the Act's general 15-year limit, and taking action to provide greater flexibility related to the statutory cap on member business lending.

a. Field of Membership

The FCU Act currently permits only federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership.[68] Modification to the FCU Act to permit all types of federally chartered credit unions to add underserved areas to their fields of membership would allow such institutions to offer financial services to those with no or limited access to federally insured financial institutions.

Specifically, federally chartered credit unions would greatly benefit from Congressional action to allow all federal charter types, not just multiple common-bond charters, to add a local community, neighborhood, or rural district that is an investment area and underserved, as determined by the NCUA Board, if the credit union establishes and maintains an office or facility within an underserved area. Allowing federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This change also could enable more credit

[68] 12 U.S.C. 1759(c)(2)

unions to participate in programs offered through the congressionally established CDFI Fund, thus increasing the availability of affordable financial services in distressed areas.

Additionally, several other statutory reforms to the FCU Act's field-of-membership provisions would enhance credit union operations, promote financial inclusion, and encourage better service of those of modest means and the underserved. These include:

- Allowing federal credit unions to serve underserved areas without also requiring those areas to be local communities;
- Simplifying or removing the "facilities" test for determining if an area is underserved;[69]
- Eliminating the FCU Act's requirement that a multiple common-bond credit union be within "reasonable proximity" of the location of a group to provide services to members of that group;[70]
- Granting explicit authority for web-based communities as a basis for a credit union charter, thus better recognizing the ways in which people share common bonds today; and
- Providing greater flexibility for low-income individuals to join federal credit unions, including by revising the FCU Act to allow the NCUA to permit federal credit unions to add anyone residing in a census tract where current estimates indicate he or she qualifies as low-income.

b. Loan Maturities

The FCU Act currently places a blanket 15-year maximum maturity on federal credit union loans.[71] The Act provides several exceptions to this blanket maturity by permitting longer limits and providing the NCUA Board the authority to set alternate limits.[72] However, these exceptions are limited. Notably, a residential real estate loan on a one-to-four-family dwelling that is *not* the primary residence of the borrower has a maximum maturity of 15 years. The same is true of member business loans and student loans. This greatly disadvantages federal credit unions and their members, including those who are already underbanked and underserved. Congressional action to provide the NCUA Board the discretion to set alternate maturity limits, such as would be

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[69] The Federal Credit Union Act presently requires an area to be underserved by other depository institutions, based on data collected by the NCUA or federal banking agencies. 12 U.S.C. 1759(c)(2)(A)(ii). The NCUA has implemented this provision by requiring a facilities test to determine the relative availability of insured depository institutions within a certain area. Congress could instead allow the NCUA to use alternative methods to evaluate whether an area is underserved to show that although a financial institution may have a presence in a community, it is not qualitatively meeting the needs of an economically distressed population.

[70] See 12 USC 1759(f)(1).

[71] 12 U.S.C. § 1757(5).

[72] *Id.* § 1757(5)(A)(i)-(iii).

granted by HR 1661, would provide a great deal of flexibility to the industry and allow them to better serve their members' needs, including those who are of modest means or underserved.

c. Member Business Lending

The FCU Act limits federally insured credit unions' member business loans to the lesser of 12.25 percent of assets or 1.75 times net worth, unless the credit union qualifies for a statutory exemption.[73] For smaller credit unions with the membership demand and the desire to serve the business segments of their fields of membership, the restriction makes it very difficult or impossible to successfully build a sound member business lending program. As a result, many credit unions are unable to deliver commercial lending services cost effectively, which denies small businesses in their communities access to an affordable source of credit and working capital.

These credit unions miss an opportunity to support the small business community and to provide a service alternative to the small business borrower. Small businesses are an important contributor to the local economy as providers of employment and as users and producers of goods and services. The NCUA believes credit union members that are small business owners should have full access to financial resources in the community, including credit unions, but this is often inhibited by the statutory cap on member business loans.

The NCUA has done its best to provide federally insured credit unions with flexibility within the statutory limits. In 2016, the NCUA modernized its member business lending rule with that aim.[74] Additionally, just a few weeks ago, the NCUA entered into a memorandum of understanding with the U.S. Small Business Administration (SBA) to enhance cooperation in increasing credit unions' awareness and knowledge of programs offered by SBA.[75] The partnership with SBA provides credit unions more opportunities to meet the credit needs of their small business members. The memorandum of understanding seeks to expand credit unions' understanding of, and participation in, SBA lending programs, including programs for certain SBA-guaranteed loans, which are statutorily exempted from the FCU Act's member business lending cap.[76] Both the NCUA and the SBA believe that credit unions are particularly well suited for expanding small business access to credit.

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[73] *Id.* § 1757a.
[74] 81 FR 13530 (Mar. 14, 2016).
[75] See "NCUA/SBA Partnership Will Help Credit Unions Support Small Businesses," available at https://www.ncua.gov/newsroom/press-release/2019/ncuasba-partnership-will-help-credit-unions-support-small-businesses.
[76] 12 U.S.C. § 1757a(c)(1)(B)(iv).

The NCUA is committed to doing everything it can to help credit unions leverage existing government loan programs so that they can provide additional capital to their small business members. Additionally, any Congressional action to provide additional flexibility under the member business lending cap would also be tremendously beneficial to the credit union industry and their small business members.

Should Congress choose to address any of these issues, I would welcome the opportunity to work with you. Thank you for the opportunity to provide an update on the strong state of the credit union industry and to detail the NCUA's recent and current initiatives and actions.

STATEMENT OF

JELENA MCWILLIAMS
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

OVERSIGHT OF PRUDENTIAL REGULATORS:
ENSURING THE SAFETY, SOUNDNESS, AND ACCOUNTABILITY OF MEGABANKS AND OTHER DEPOSITORY INSTITUTIONS

before the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

May 16, 2019
2128 Rayburn House Office Building

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for the opportunity to testify today before the House Committee on Financial Services. As we quickly approach my first anniversary as Chairman, I appreciate the opportunity to share with the Committee how the Federal Deposit Insurance Corporation (FDIC) is working to ensure our regulated institutions are serving their communities and how our regulatory and supervisory efforts are strengthening the agency's oversight of depository institutions of all sizes.

The Financial Needs of Communities

Our nation's banks are the center of economic activity in their communities. The ability of these banks to provide safe and secure financial products and services to their customers forms the backbone of a strong national economy. The FDIC's oversight of these banks is critical to financial stability and consumer protection. It is incumbent that we exercise this oversight in a manner that recognizes an institution's business model and does not impose unnecessary costs or burdens on legitimate activities.

For these reasons, I have focused much of my efforts at the FDIC on understanding the needs of our communities and the banks that serve them. Our Community Bank Advisory Committee (CBAC), composed of bankers from across the nation, has been a valuable resource in this regard. By the end of the summer, I will also be nearly halfway through my 50-state listening tour. These meetings with local bankers, state supervisors, consumer groups, and our FDIC employees have been incredibly informative, and have underscored how important it is to get perspectives on our regulatory efforts outside the D.C. "beltway."

Based on the feedback from our banks and the communities they serve, I have challenged the FDIC to increase our efforts to:

- Promote and preserve the nation's Minority Depository Institutions (MDIs);
- Encourage community banking, including the establishment of *de novo* banks in communities of all sizes;
- Provide clarity and consistency to financial institutions on their obligations under the Community Reinvestment Act (CRA); and
- Ensure that banks can help low- and moderate-income households – who are often unbanked or underbanked – meet their financial needs safely when confronted with a crisis.

Minority Depository Institutions

Many of the institutions overseen by the FDIC are small banks, including MDIs, whose communities have unique needs for accessing financial services, and our oversight must reflect their critical role in our financial system. The FDIC embraces its statutory responsibility to preserve and promote the health of MDIs. The vitality of these banks is critical given their role in the economic well-being of the minority and traditionally underserved communities many MDIs serve.

The FDIC has a number of initiatives underway to support MDIs:

- In 2018, we appointed a full-time, permanent executive to manage our MDI programs across the FDIC, and have increased the representation of MDIs on the CBAC from one to three institutions, where MDIs now represent one-sixth of CBAC members.

- In June of this year, we will host the first of several roundtables between MDIs and other FDIC-supervised institutions to share expertise and to promote possible collaborative opportunities, including direct investments and deposits in MDIs.
- In June, the FDIC will publish a research study on MDIs and host the 2019 Interagency MDI and Community Development Financial Institution (CDFI) Bank Conference.
- We continue to provide technical assistance to groups seeking to organize new MDIs, and to existing MDIs to support their efforts to acquire failing institutions (including three regional roundtables and two webinars over the last few months, an additional webinar in the future, and a workshop at our June MDI and CDFI conference).
- This fall, we will establish a new MDI subcommittee on the CBAC to both highlight the MDIs' efforts in their communities and to provide a platform for MDIs to exchange best practices.

Beyond these outreach efforts, the FDIC is working on a revised policy statement to underscore our commitment to the health of MDIs. We will continue other technical assistance efforts with these banks, including with groups seeking to create new MDIs.

Streamlining the De Novo Application Process

Banks – particularly community banks – are the economic heartbeat of communities of all sizes across the United States. New financial institutions preserve the vitality of the banking sector, fill important gaps in banking markets, and provide credit services to markets that may be overlooked. The FDIC is open to, and supportive of, deposit insurance filings from all firms, including fintechs. All applications for deposit insurance must be evaluated under the statutory requirements enumerated in Section 6 of the Federal Deposit Insurance Act (FDI Act).

While very few new banks opened in the years following the crisis, the FDIC is seeing renewed interest from organizers. To support the formation of these new institutions, the FDIC is reviewing its processes related to deposit insurance applications. For example, we have revised how we receive and review draft deposit insurance proposals. Under our new procedures, we now provide initial feedback to organizers on draft applications prior to formal submission, which helps them develop more actionable applications. To solicit additional ideas for improvement, we also conducted significant outreach efforts to engage the public, including issuing a Request for Information (RFI) last fall and holding seven roundtable events across the country.

CRA

Last year, the Office of the Comptroller of the Currency (OCC) solicited public feedback on how CRA regulations could be modernized to improve the effectiveness of the law and provide much needed clarity to financial institutions on compliance. The OCC, FDIC, and the Federal Reserve Board (FRB) have reviewed the comment letters received by the OCC and are working together on a proposal for a revised regulatory framework that can help meet these dual goals.

As these efforts proceed, our focus should include: clarifying what activities qualify for CRA consideration; reviewing how we assess lending – including digital lending – by banks outside of their main offices and branches; and ensuring that CRA investments target those most in need in a bank's community.

Small-Dollar Lending

According to a recent study by the FRB, nearly four in 10 households cannot cover a $400 emergency expense with cash.[1] While some banks offer small-dollar lending to help those in need, many banks have chosen not to offer such products because of regulatory uncertainty.[2] As a result, many families rely on non-bank providers to cover these emergency expenses, or their needs go unmet.

To solicit feedback on these products and consumer needs, the FDIC issued an RFI last year to learn more about small-dollar credit needs and concerns. We have reviewed the more than 60 comments received and plan to revisit our 2013 guidance to ensure that it does not impose an impediment to banks considering the extension of responsible small-dollar credit.

Appraisal Thresholds

Last year, the FDIC and our partner agencies finalized a proposal to raise the appraisal threshold for federally related commercial real estate transactions from $250,000 – where it was set in 1994 – to $500,000. Additionally, the agencies proposed raising the threshold for federally related residential real estate transactions from $250,000 – also set in 1994 – to $400,000. These

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[1] *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.
[2] The three prudential banking agencies have each taken a separate approach to small-dollar lending at the institutions they regulate. See 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.

Additionally, the Consumer Financial Protection Bureau has promulgated a rule that is now being revisited. See *CFPB Notice of Proposed Rulemaking to Delay the August 19, 2019 Compliance Date for the Mandatory Underwriting Provisions of the 2017 Final Rule to November 19, 2020* (February 6, 2019), available at: https://files.consumerfinance.gov/f/documents/cfpb_payday_nprm-2019-delay.pdf; and *CFPB Notice of Proposed Rulemaking to Rescind Certain Provisions of its 2017 Final Rule Governing Payday, Vehicle Title, and Certain High-Cost Installment Loans* (February 6, 2019), available at: https://files.consumerfinance.gov/f/documents/cfpb_payday_nprm-2019-reconsideration.pdf.

proposed changes balance current market realities and price 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. We have received numerous comments on these proposals and are currently working to finalize the rulemaking.

Regulatory Efforts to Strengthen the Financial System

The FDIC strives to implement its regulatory approach to Insured Depository Institutions (IDIs) in a manner that reflects differences in risk profile among industry participants, while achieving our goals for a safe, sound, and stable banking system. To support our regulatory efforts, FDIC examiners conduct bank examinations using a risk-focused examination program, which helps the FDIC identify emerging risks and take supervisory or regulatory actions to help mitigate those risks. Our ability to effectively supervise larger institutions is a particularly critical foundation for our regulatory efforts and to ensure that large and complex financial institutions are resolvable in an orderly manner.

The FDIC is the primary federal regulator for 3,495 state-chartered institutions that are not members of the Federal Reserve System.[3] Of this number, 40 have assets above $10 billion. We have adopted a comprehensive and uniform supervisory process for oversight of these larger institutions. For institutions where the FDIC is the primary regulator, we generally apply a continuous examination program with dedicated staff conducting ongoing, on-site supervisory examinations and off-site institution monitoring. Staff works closely with other regulators to identify emerging risks across the agencies' portfolio of large institutions, assess the overall risk profile of the institutions, and promote consistency in supervisory approach.

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[3] As of December 31, 2018.

The FDIC's Large Insured Depository Institution (LIDI) Program remains a primary tool for off-site monitoring of large IDIs, with the exception of the most complex IDIs. The LIDI Program provides a comprehensive process to standardize data capture and reporting for large institutions nationwide, allowing for quantitative and qualitative risk analysis. The LIDI Program supports effective large bank supervision by using individual institution information to focus resources on higher risk areas, determine the need for supervisory action, and support insurance assessments and resolution planning.

The FDIC regularly monitors the potential risks at all IDIs, including those for which it is not the primary federal supervisor. Through close coordination and collaboration with the OCC, FRB, and various state bank regulators, the FDIC monitors all institutions to ensure the Deposit Insurance Fund (DIF) is not placed at risk, and when necessary, exercises the authority to conduct special (backup) examination activities of IDI's where the FDIC is not the primary regulator.

For the most complex firms (the Global Systemically Important Banks, or G-SIBs), the FDIC has also established a Systemically Important Financial Institution (SIFI) Risk Report that is used to identify key vulnerabilities and assess capital sufficiency.

Appropriately Tailoring Regulatory Efforts

Given the difference in size and complexity at our nation's financial institutions and the continued evolution of the financial services industry and our economy as a whole, it is vital that the FDIC continuously evaluate the regulatory framework for IDIs.

Congress directed specific action with respect to regulatory tailoring in the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Beyond EGRRCPA, the FDIC has a responsibility to regularly revisit prior regulations and guidance to ensure that we are

appropriately addressing new risks to the system and are not imposing unnecessary regulatory burdens that might impede safe and secure banking activities. In addition, under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), the FDIC has a responsibility to review our regulations at least once every 10 years to identify any outdated, unnecessary, or unduly burdensome requirements. To meet the congressional mandates of EGRRCPA and EGRPRA and our general regulatory responsibilities, the FDIC has taken numerous actions over the past year to appropriately tailor our regulatory approach to the risk presented by the individual institutions we oversee, while maintaining requisite safety and soundness and consumer protection.

EGRRCPA

Consistent with the statutory mandates in EGRRCPA, the FDIC has undertaken targeted changes to simplify the regulatory regime for community banks and small and mid-size regional banks based on their risk profiles, while maintaining the most robust capital and liquidity standards for our nation's largest, most systemically important banks. The FDIC has made considerable progress in implementing the requirements of EGRRCPA. For example, the FDIC has issued:

- An interagency proposal to incorporate exemptions from appraisal requirements for certain rural transactions (Section 103);
- A final rule to except a limited amount of reciprocal brokered deposits from being reported in Reports of Condition (Section 202);
- An interagency proposal to allow reduced reporting requirements in the first and third calendar quarters for certain institutions (Section 205);

- An interagency interim final rule to treat certain municipal obligations as high-quality liquid assets for purposes of calculating the liquidity coverage ratio (Section 403);
- Two interagency proposals to tailor capital and liquidity requirements according to risk-based categories, one for domestic and one for foreign banking organizations with total consolidated assets of $100 billion (Section 401);
- An interagency proposal to amend the supplemental leverage ratio for custodial banking organizations (Section 402); and
- An interagency proposal to revise the definition of a high-volatility commercial real estate exposure (Section 214).

Volcker Rule

Having observed several years of Volcker Rule compliance by FDIC-regulated entities, it has become clear that the rule as originally constructed is extremely complex and too subjective, resulting in uncertainty and unnecessary burden for smaller, less complex institutions.

To address some of these concerns, Congress exempted from the Volcker Rule all banks below $10 billion in consolidated assets that do not engage in significant trading activity. The five agencies[4] responsible for implementing the Volcker Rule have issued a notice of proposed rulemaking to fulfill the requirements of Section 203, which we expect to finalize soon.

Notwithstanding the proposed changes in EGRRCPA, the five agencies issued a separate, additional proposal, broadly referred to as Volcker 2.0. This proposal sought to simplify the rule and reduce the amount of subjectivity in its implementation. Benefitting from a review of 151 comment letters, we are working with our partner agencies toward revisions to the Volcker Rule to provide more clarity, certainty, and objectivity to market participants.

[4] The agencies responsible for implementation of the Volcker Rule include the FDIC, OCC, FRB, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

Brokered Deposits Advance Notice of Proposed Rulemaking

The FDIC is undertaking a comprehensive review of our long-standing 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 December 2018, our Board approved an Advance Notice of Proposed Rulemaking (ANPR) to seek public comment on all aspects of the FDIC's brokered deposit and interest rate regulations with a comment period that closed on May 7. In particular, we have heard concerns about the current methodology for calculating national rate caps applicable to less than well capitalized banks, and we appreciate the urgency surrounding this issue. The FDIC is expediting the rate cap component of our review with the goal of issuing a proposal for comment and a final rule by the end of the year.

Community Bank Leverage Ratio

Efforts to comply with Basel III capital standards have imposed substantial compliance costs on community banks. In fact, at the time of the U.S. Basel III rulemakings, the FDIC, OCC, and FRB found that the vast majority of community banks already maintained sufficient capital levels to exceed the new minimum thresholds.[5] The Basel III standards, which were intended for internationally active banks, are simply too complex and ultimately unnecessary for community banks.

[5] See OCC and the FRB Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 FR 198 (October 11, 2013).

In September 2017, the FDIC took an initial step to streamline the capital regime for small banks by issuing the proposed "capital simplification rule" under EGRPRA.[6] This proposed rule would modify the treatment of mortgage servicing assets, certain deferred tax assets, and investments in unconsolidated financial institutions, such as Trust Preferred Securities (TruPS), among other provisions. The FDIC will finalize this capital simplification proposal in the next few weeks.

In the meantime, Section 201 of EGRRCPA directed the FDIC to provide an optional community bank leverage ratio (CBLR) for qualifying community banks. The FDIC, OCC, and FRB issued a proposal to implement the CBLR in November 2018.[7]

Under the proposed CBLR rule, a qualifying bank with less than $10 billion in consolidated assets would not have to comply with the existing risk-based capital requirements if the bank meets a simple ratio of tangible equity to total assets. The proposal includes a definition of tangible equity that is designed to be very simple to calculate and includes high-quality, loss-absorbing capital. In order to qualify under the proposal, banks will need to satisfy certain activity-related criteria and calculate a simple leverage ratio. This approach is most appropriate for small banks with traditional business models. Another key feature of the CBLR proposal is that it is optional.

We estimate that over 80 percent of community banks would be eligible for the proposed CBLR based on the proposed calibration and qualifying criteria. This was a key priority in

[6] See FDIC Notice of Proposed Rulemaking *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, FIL-45-2017 (September 27, 2017), available at: https://www.fdic.gov/news/news/financial/2017/fil17045.pdf.
[7] See OCC, FRB, and the FDIC Notice of Proposed Rulemaking, *Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations*, 84 FR 3062 (February 8, 2019), available at: https://www.fdic.gov/news/board/2018/2018-11-20-notice-sum-b-fr.pdf.

designing the proposal – to ensure that the simple ratio would be available broadly and without too many complex restrictions.

A key burden reducing aspect of the proposal is that the CBLR would require a single page of regulatory reporting, a substantial reduction from the 15 pages currently required.

Since the agencies issued the CBLR proposal, we received numerous helpful comments and are carefully reviewing each of them. For example, we have heard feedback on the CBLR levels proposed as proxies under the Prompt Corrective Action (PCA) framework. These proxies were included in the proposal as an option for institutions that fall below the CBLR to allow them to continue to use the framework. Reverting to Basel III based capital calculations at a time when they should be focused on addressing their declining capital position could be resource intensive and counterproductive for a small bank. We recognize that this has caused some concern and are considering how best to proceed with this feature of the proposal based upon the comments.

Stress Tests

Section 401(a) of EGRRCPA raised the minimum consolidated asset threshold for financial company-run stress tests from $10 billion to $250 billion. In July 2018, the FDIC, OCC, and FRB gave immediate relief from these requirements to banking organizations with less than $100 billion in assets. We expect to finalize the proposed rules to implement these statutory changes in the coming months.

The agencies are also considering amendments to the 2012 Stress Testing Guidance that would provide for further tailoring of supervisory expectations. In particular, the agencies are considering raising the asset threshold in the 2012 Stress Testing Guidance to $100 billion. Under such an approach, banking organizations under $100 billion in assets would be expected

to use appropriate risk management processes to address risks in specific subject matter areas rather than undertake a general, comprehensive stress testing framework more appropriate for larger firms.

Resolution Planning

The FDIC is tasked with resolving failed banks and, if called upon, large bank holding companies or other SIFIs. To support this mandate and improve their resolvability, the largest bank holding companies are required by law to submit resolution plans outlining how they can fail in an orderly way under the Bankruptcy Code.

Since the resolution planning requirements took effect in 2012, large firms have improved their resolution strategies and governance, refined their estimates of liquidity and capital needs in resolution, and simplified their legal structures. For example, the U.S. G-SIBs have developed a single-point-of-entry (SPOE) resolution strategy that is intended to enable the functioning of critical operations at key subsidiaries, while the parent enters a preplanned bankruptcy proceeding designed to facilitate the recapitalization of key subsidiaries, preserve going concern value, and protect financial stability. These firms have also established clean holding companies and issued long-term debt which can be converted to equity in the event of a failure. These actions help ensure that market participants — not taxpayers — bear the risk of loss.

In addition to the bankruptcy planning requirements for the largest U.S. bank holding companies, the FDIC also reviews resolution plans filed by larger IDIs planning for resolution under the FDI Act (IDI Rule). This work, along with other measures, has improved our readiness for these resolutions.

Based on experience implementing both rules, the FDIC issued two proposals in April to build on progress already made and to make the resolution process more efficient and effective. The proposals reflect my views that resolution planning for the largest institutions is critical, and we can make improvements to the process.

First, the FRB and the FDIC published for public comment a proposal that would modify resolution plan requirements for large bank holding companies. This proposal implements changes to resolution planning requirements under EGRRCPA, and proposes exempting smaller regional banks from the rule. The proposal also seeks to codify a reduction in frequency of submissions, reflecting the current two-year filing schedule for the largest domestic bank holding companies, and proposes a three-year filing schedule for other filers. The proposal would also allow firms to submit targeted plans focused on the most material topics identified by the FDIC and FRB, including capital, liquidity, and material changes that have occurred in between full submissions. Still, plans submitted would remain subject to rigorous review by both agencies.

Second, the FDIC published for public comment an ANPR that seeks comment on potential changes to the IDI Rule. Among other issues, the agency is considering whether to revise the threshold for application of the rule and to tier the rule's requirements based on the size, complexity, or other characteristics of an IDI. The agency is also seeking feedback on ways to streamline plan submissions for larger, more complex firms and on whether to replace plan submissions with periodic engagement and capabilities testing for smaller, less complex firms that are subject to the rule.

The Role of Guidance

As a supervisor, our rules and expectations should be clear to those we supervise. A key aspect of effective supervision is providing a level of certainty surrounding compliance with applicable laws and regulations.

Related to this concept, much has been said about the role of guidance in our regulatory and supervisory framework. Under the Administrative Procedures Act, a rule is defined, in part, as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[8]

Separately, there is supervisory guidance. Supervisory guidance can be a helpful tool to provide clarity to our regulated institutions and to FDIC supervisory staff on how to operate in a safe and sound manner, be fair to consumers, and comply with applicable laws and regulations. But supervisory guidance documents are *not* the same as rules, and should not be treated as such.

In September, the FDIC joined several other agencies to issue a statement clarifying to examiners and financial institutions that institutions cannot be criticized for "violations" of guidance, only for violations of law, regulation, or other enforceable conditions. We have taken a number of steps to ensure our examiners understand this, including written instructions, all-hands examiner calls, and in-person training. We also are reviewing our outstanding guidance documents, the role such guidance documents play in the examination process, and our approach to issuing supervisory guidance going forward, including compliance with the Congressional Review Act.

[8] 5 U.S.C. §551(4).

Supervisory Efforts to Ensure Safety, Soundness, and Consumer Protection

As noted, the FDIC is the primary federal regulator for 3,495 institutions.[9] The FDIC also has backup supervisory responsibilities under the FDI Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[10] These supervisory activities (whether as a primary regulator or in conjunction with our partner agencies) are critical to fulfilling our statutory mandate to protect the DIF and to ensure the stability of, and public confidence in, the nation's financial system.

Supported by our supervision efforts and a strong economy, our nation's banks are stronger than ever. Over the last ten years, we have replenished the DIF to $102.6 billion,[11] representing a ratio of 1.36 percent compared to industry estimates of insured deposits. No institutions failed in 2018, and none have failed thus far in 2019. The FDIC also decreased the number of receiverships under management by 66 last year, and has terminated an additional nine receiverships this year, leaving 263 receiverships under management at this time.

Our efforts to investigate bank failures and identify possible violations of law and regulation help hold banks accountable, as well as their officers, directors, and other employees or contractors. During 2018 alone, the FDIC recovered $116.3 million from professional liability claims and settlements. Recently, the FDIC concluded a historic $335 million settlement, tying a record for the largest settlement ever by any plaintiff in an accounting malpractice case.[12] Working with the Department of Justice, the FDIC also helped collect $8.3 million in criminal restitution and forfeiture orders in 2018.

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[9] As of December 31, 2018.
[10] 12 USC Sections 1820(b)(3) and 1818(t).
[11] As of December 31, 2018.
[12] The aggregate amount of the settlement was $395 million, when the additional $60 million settlement against another party in the action is counted. FDIC Press Release, *FDIC Settles with PricewaterhouseCoopers LLP on Audits of a Failed Bank*, PR-19-2019 (March 15, 2019). Available at: https://www.fdic.gov/news/news/press/2019/pr19019.html.

The FDIC also initiates enforcement actions based on unsafe and unsound practices or conditions in institutions, violations of law and final agreements, and breaches of fiduciary duty, dishonesty or willful disregard by institution-affiliated parties. In that regard, the FDIC initiated 100 formal enforcement actions in the last year, which included 23 cease-and-desist actions, 52 actions to remove individuals from the banking industry, and 25 civil money penalties for illegal conduct. More than $20 million was provided in restitution to consumers affected by improper practices during the year. Taken together, these supervisory and enforcement actions help protect our financial system and the customers that rely on financial institutions for safe and secure products and services.

Risk Monitoring

Our supervision efforts also help to identify and mitigate risks to the financial system, working both independently and in partnership with our fellow regulators. The FDIC is an active participant in the Financial Stability Oversight Council (FSOC), working with other regulators to monitor activities and events that could pose risks to the financial system. These coordinated efforts help to identify emerging risks to the financial system and are particularly salient in two areas, leveraged lending and cyber threats.

<u>Leveraged Lending</u>

With respect to direct exposure to leveraged loans, banks generally hold the revolving portion of leveraged transactions, which tends to be less risky than the portion held by institutional investors. Nonetheless, risks could flow back into banks through pipeline risk, indirect exposure through financing to non-bank lenders, and investment in collateralized loan obligations (CLOs). In addition, a significant rise in leveraged loan defaults could have broader

economic impacts that affect both bank and non-bank sponsors of leveraged loans, and is something the FDIC is carefully monitoring.

Moreover, the FDIC continues to monitor the risks posed by leveraged lending, including developments in the market, growth in leveraged lending, concentrations of exposure at financial institutions, and associated underwriting standards. We are engaged in a continuous dialogue with other regulatory agencies on this matter.

Cyber Threats

The FDIC is also actively monitoring 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. To support banks in this regard, we recently added two new scenarios to a tool available on our website named "Cyber Challenge." Cyber Challenge is a set of ready-to-use scenarios and questions to assist banks as they discuss operational risk and the potential impact of information technology disruptions on banking functions. Notwithstanding these efforts, the risks posed by cyber threats remain persistent, and the fight against these threats will require continued joint efforts by the public and private sectors.

Transparency

The FDIC's responsibilities to preserve and promote confidence in the financial system and to protect the DIF also require openness and accountability to the public and insured institutions. To support these principles, we launched the FDIC's "Trust through Transparency"

initiative in 2018 and created a new section on the FDIC's public website where we publish FDIC performance metrics.[13]

The site also contains guidelines and decisions related to appeals of material supervisory determinations and deposit insurance assessments, as well as policies and procedures for how we conduct our work. Additionally, we made publicly available information on how our case managers and examiners implement the risk-focused supervision program. The FDIC is further reviewing our processes to ensure we have the proper balance between protecting confidential information and providing public access, and we will add to this website over time.

BSA/AML Compliance

Bank Secrecy Act and Anti-Money Laundering (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. These terrorists and criminals use increasingly sophisticated methods to conceal their transactions in an evolving financial, technological, and regulatory landscape.

The FDIC and the institutions we supervise for BSA/AML compliance recognize the importance of BSA/AML reporting. Nonetheless, the FDIC also recognizes that meeting these compliance obligations imposes billions of dollars in compliance costs at regulated institutions.

Considering these costs, we continue to encourage the Financial Crimes Enforcement Network (FinCEN) and our partners in law enforcement and the intelligence community to actively communicate the importance of this reporting and the impact that it has on their efforts

[13] *FDIC Transparency & Accountability* (October 04, 2018), available at: https://www.fdic.gov/transparency/.

to detect, deter, and disrupt criminal and terrorist organizations. At a recent CBAC meeting, FinCEN provided just such an eye-opening and unclassified briefing to CBAC members.[14]

In addition to these communication and outreach efforts, the FDIC, along with the other federal banking agencies and the Department of the Treasury, including FinCEN, have convened a working group to focus on initiatives to improve the efficiency and effectiveness of the BSA/AML regulatory regime. The working group has already released statements encouraging innovation in BSA/AML compliance and identifying areas where banks can share compliance resources.[15]

CAMELS Ratings

Since I arrived at the FDIC, I have sought to review longstanding processes and procedures that have not received regulatory scrutiny or updating in a decade or more to determine if they warrant modernization. One such supervisory tool is the interagency CAMELS ratings system that has been in place for more than 20 years and is vital to our supervisory efforts. Given its maturity and subsequent changes in the industry and technology, it is appropriate to ask for the public's views on the existing approach, how it has been implemented, whether it has been applied consistently to institutions of varying sizes, business models, complexity, and risk profiles, and the impact of various ratings on supervisory actions, including enforcement proceedings and application reviews. I have asked staff to develop options for working with other Federal Financial Institutions Examination Council (FFIEC) members to seek the public's input on this topic.

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[14] *FDIC Advisory Committee on Community Banking. Archived Videos/Webcast of Advisory Committee Meeting* (March 28, 2019), available at: http://fdic.windrosemedia.com/.
[15] FRB, FDIC, FinCEN, NCUA, and OCC *Interagency Statement on Sharing Bank Secrecy Act Resources*, FIL-55-2018 (October 3, 2018), available at: https://www.fdic.gov/news/news/financial/2018/fil18055.pdf.

Reducing Community Bank Examination Burden

The compliance officer at many of our community banks wears many hats, and may also be the Chief Financial Officer, a loan officer, and a teller. If we can make compliance at our nation's community banks less complex, while maintaining safety and soundness and consumer protections, we can help banks focus resources on the business of banking their communities, not dealing with bureaucracies. As an example, the FDIC was able to archive nearly 60 percent (493) of 837 pieces of supervisory guidance just by eliminating outdated and duplicative documents that had never been archived in more than two decades. We were able to take these steps without compromising the safety of the institutions or the stability of the financial system as a whole.

We have also incorporated additional risk-focusing and leveraged technology in our examinations to reduce the amount of time we are on-site at an institution without sacrificing the quality of our examinations. Risk-focusing allows our examiners to review information from an institution before an examination begins; to gain a better understanding of the institution's business model, complexity, and risk profile; and to focus resources during an exam on areas that present the most risk to the institution or its customers. Technology has allowed our examiners to perform some examination activities at the local field office instead of on-site at the institution, and we are focusing on additional opportunities to take advantage of technology in the examination process.

In 2018, risk-focusing and leveraging technology for consumer compliance exams allowed the FDIC to conduct an average of 62 percent of our examination off-site. We have incorporated similar risk-focusing and technology in our prudential exams, and have cut on-site days from 27 in 2010 to 23 in 2018. As we train our examiners more on the use of these

techniques and incorporate new technology, we will further cut the costs of our exams on institutions without compromising on quality.

Leveraging Technology

The FDIC supports innovation in the financial services industry, with particular focus on community banks. To ensure that we are prepared to address the changing landscape in financial services, the FDIC has dedicated significant resources to identify and understand emerging technologies. In October 2018, I announced that the FDIC would be launching an office of innovation, which we have since named the FDIC Tech Lab, or FDiTech for short.

While some banks have spent substantial sums on new technology and others have partnered with fintechs to expand their products and services, many banks – especially smaller banks – have been reluctant or simply unable to invest. We have already engaged with banks to understand how they are innovating and to promote technological development at community banks with limited funding for research and development. We are also looking at policy changes that may be needed to encourage innovation, while maintaining safe and secure financial services and institutions. Rather than play "catch up" with technological advances, the FDIC's goal is to stay on the forefront of changes through increased collaboration and partnership with the industry, to promote increased competition in the financial services sector, and to support innovation at community banks, including MDIs.

Modernizing the FDIC

As the financial services industry changes, the FDIC must evolve.

Over the last year, we have made significant investments in new technology within the FDIC. Our Chief Information Officer has initiated a data management initiative that will

promote information sharing within the FDIC and will enable the application of advanced analytic tools to FDIC data sets, including machine learning and artificial intelligence.

We have also established a Supervision Modernization Subcommittee for the CBAC. This subcommittee – composed of banks, technologists, legal experts, former regulators, and distance learning leaders – will make recommendations to the CBAC for improving our supervision activities. These recommendations will support new investments in technology and improvements in our supervision processes, including how we hire, train, and deploy our workforce.

Maintaining a Diverse Workforce

As I explained to the FDIC workforce in my inaugural equal employment opportunity policy statement, my personal and professional experiences have highlighted the importance of a workplace that is free from discrimination and that supports diversity and inclusion. The FDIC has a long-standing commitment to diversity. The racial, ethnic, and gender diversity of the FDIC workforce continues a steady increase since 2010 with minority representation at 29.9 percent and with women comprising 44.9 percent of permanent employees. We have continued our efforts to promote the participation of Minority and Women-Owned Businesses in FDIC contracting actions. We will continue to cultivate an FDIC that is accessible, inclusive, and diverse, treating everyone with dignity and respect while embracing our differences.

Conclusion

Most of my professional life has been focused on the financial services industry. Before my tenure at the FDIC, I intuitively understood how important our nation's banks were to the economy. But until I had real conversations with bankers, their customers, and state supervisors

on my 50-state listening tour, I did not fully appreciate how our banks – particularly community banks – are so intimately involved in the fabric of their communities and customers' lives. Across the country, these banks help fund a town's grocery stores, barber shops, restaurants, local libraries, and small businesses. In rural communities and urban settings, our banks provide a critical lifeline for low- and moderate-income customers, while supplementing infrastructure and social services.

The FDIC's role is to provide the confidence needed for customers to trust those banks with their deposits. Every day, I am proud to join my colleagues at the FDIC in fulfilling our mission to preserve and promote public confidence in the U.S. financial system. And I would be remiss if I did not mention the 6,000 dedicated FDIC employees who go to work every morning laser-focused on protecting the stability and integrity or our financial system. To them, I am most grateful for their warm welcome and for being open to the accountability, transparency, and collegiality that make me proud to run such an exceptional agency.

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

For Release Upon Delivery
10:00 a.m., May 16, 2019

TESTIMONY OF

JOSEPH M. OTTING

COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

May 16, 2019

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

Chairman Waters, Ranking Member McHenry, and members of the Committee, thank you for the opportunity to testify on the Office of the Comptroller of the Currency's (OCC) supervision and regulation of financial institutions. My testimony today primarily focuses on the condition of the federal banking system, and the OCC's priorities and objectives.

Condition of the Federal Banking System and Assessment of Risks

As of the end of 2018, the federal banking system comprised more than 1,200 national banks, federal savings associations, and federal branches of foreign banks (banks) operating in the United States. These banks range in size from small community banks to the largest most globally active U.S. banks. The vast majority of national banks and federal savings associations, approximately 968, have less than $1 billion in assets, while more than 60 have greater than $10 billion in assets. Combined, these banks hold $12.7 trillion or almost 70 percent of all assets of U.S. commercial banks. These banks also manage more than $50 trillion in assets held in custody or under fiduciary control, which amounts to 43 percent of all fiduciary and custodial assets in insured U.S. banks, savings associations, and national trust banks. The federal banking system holds nearly three-quarters of credit card balances in the country, while servicing almost a third of all residential mortgages. Through their products and services, a majority of American families have one or more relationships with an OCC-regulated bank.

The condition of the federal banking system is strong. The financial performance of banks making up the federal banking system strengthened in 2018 and early 2019, driven primarily by strong operating performance. Capital and liquidity remain at or near historic highs. Return on equity is near pre-crisis levels, and OCC-supervised banks reported healthy revenue growth in 2018 compared with 2017. Net income increased 25 percent for banks with total assets of less than $1 billion and increased nearly 50 percent for the federal banking system as a whole,

with tax cuts resulting from the Tax Cuts and Jobs Act accounting for approximately half of the increase. Asset quality has historically been impacted by cyclicality; however, as measured by traditional metrics such as delinquencies, nonperforming assets, and losses, asset quality is currently strong and stable. Loan performance is the best it has been in the past decade.[1]

The health of the federal banking system is reflected also in the declining number of outstanding Matters Requiring Attention (MRA) concerns. One way the OCC communicates supervisory concerns about a bank's deficient practices to a bank's board and management is in the form of MRAs. In 2018, the number of outstanding MRA concerns declined for the sixth consecutive year and to the lowest level since 2006. Banks have invested significant time and resources addressing our supervisory concerns, and the declines in outstanding MRAs represent sustained improvements in bank governance, oversight, and risk management systems and controls.

While the condition of the federal banking system is strong, the OCC monitors risks to the system on a continuous basis and publishes a summary of risks facing banks twice a year in our *Semiannual Risk Perspective*. Key risks highlighted in the most recent issue of the report, published in December 2018, include credit, operational, compliance, and interest rate, as discussed below. These areas continue to evolve in the context of changing economic, technological, and bank operating developments.

Credit quality remains strong when measured by traditional performance metrics. Nonetheless, credit risk is increasing because of accumulated risk in loan portfolios from successive years of incremental easing in underwriting, risk layering, concentrations, and rising

[1] See *Semiannual Risk Perspective*, Fall 2018 (https://occ.gov/publications/publications-by-type/semiannual-risk-perspective/pub-semiannual-risk-perspective-fall-2018.pdf).

potential impact from external factors. The OCC continues to monitor the effects of strong competition, within and outside the federal banking system, particularly on the origination quality of new loans. In addition, the OCC is monitoring for any increased levels of lender complacency within credit risk identification and management.

Operational risk is elevated as banks respond to an evolving and increasingly complex operating environment. Cybersecurity continues to be a key operational risk, especially in light of the continually evolving threat landscape. Innovation in the banking industry emphasizes the need for banks to effectively manage operational changes as technology advances. Banks increasingly rely on third-party service providers to deliver key services, which presents distinct risks. Further, there are examples of core activities for the industry that are concentrated in a handful of third-party service providers. Additional factors contributing to elevated operational risk are the expected increase in mergers and acquisitions activity as well as rising trends in fraud and attempted fraud. Operational disruptions underscore the need for effective change management when implementing new products, services, and emerging technologies.

Compliance risk remains elevated as banks seek to manage money-laundering risks in a complex, dynamic operating and regulatory environment. In addition, the adoption of new technologies and other innovations and implementing changes to policies and procedures to comply with amended consumer protection requirements are challenging banks' compliance risk management processes.

Interest rate risk poses potential challenges given the current rising rate environment, competitive pressures, changes in technology, and untested depositor behavior. All these factors make it difficult to forecast liability costs. The advances in technology, such as online banking, mobile banking, and the acceleration of fintech, have made it easier to move money, potentially

causing depositors to switch financial institutions or switch to nonbank competitors. Banks may experience unexpected shifts in liability mix or increasing costs that could reduce earnings or increase liquidity risk.

A specific credit risk that warrants attention involves the leveraged loan market. The federal banking agencies have increasingly observed transactions that include elevated leverage, including fewer and less stringent protective covenants, more liberal repayment terms, and incremental debt provisions that allow for increased debt that may inhibit deleveraging capacity and dilute repayment to senior secured creditors. We continue to monitor how this combination of risks is evolving and to assess the adequacy of bank risk management and controls. Through our supervisory activities, we have seen that the leveraged lending guidance issued by the federal banking agencies has contributed to banks having a more balanced risk management approach in this area. We will also continue to monitor the potential impact of these risks in the aggregate on the broader leveraged lending market and banking system.

Bank holdings of leveraged loans are not our only significant concern. Although supervised banks originate a significant portion of leveraged loans, nonbank entities have substantially increased their purchases of leveraged loans. Most of the problem loan leveraged loan exposure is held outside of the regulated banking system where there is much less transparency. While purchases of leveraged loan participations by nonbank entities allows the risks to be shared more broadly, the nonbank entities may not be required to hold the levels of capital and liquidity that supervised financial institutions must hold to protect them in an economic downturn or during a period of market disruption.

As is our practice, the OCC will continue to assess leveraged lending risk regularly through the supervisory process. Recent supervisory assessments show that OCC regulated banks

have satisfactory risk management around leveraged lending. Leveraged loans can also present indirect risk and we will continue to assess OCC regulated banks' management of risks from lending to leveraged loan investors, lending to and investing in collateralized loan obligations, and from other borrowers that may have critical suppliers or vendors that are highly leveraged. In addition, although less transparent to the federal banking agencies, we will continue to monitor nonbank leveraged lending activity and its potential impacts to the extent possible.

The federal banking agencies will continue to perform semi-annual interagency shared national credit (SNC) reviews. These reviews are risk-based and focus on loans shared by at least three regulated entities with a committed value of $100 million or greater. For some time, SNC reviews have been heavily weighted towards leveraged loans, and results are used by examiners when assessing credit quality and risk management practices at individual banks that originate or purchase portions of those loans. The federal banking agencies issue a joint, annual public statement to summarize SNC findings.

OCC Priorities and Objectives

The federal banking system should be an engine to promote economic growth and prosperity for consumers, businesses, and communities across the country. My priorities address tailoring regulatory requirements to remove unnecessary burden, and increasing bank lending and investment in the businesses and communities the banks serve. They include modernizing the Community Reinvestment Act (CRA) to increase lending, investment, and financial education to where it is needed most; encouraging banks to meet short-term small-dollar credit needs to provide consumers with additional safe, affordable credit choices; completing the implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act (Economic Growth Act) to reduce regulatory burden for small and mid-size institutions while

safeguarding the financial system and protecting consumers; and supporting responsible innovation to provide more choices to consumers and businesses. My priorities also include improving the efficiency and effectiveness of Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) regulations, supervision, and examination, while continuing to support law enforcement, protect the financial system from those who seek to exploit it for illicit and illegal purposes, and reduce the burden of BSA/AML compliance; and working with the other federal agencies to implement the incentive compensation provisions of section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Modernization of the Community Reinvestment Act

During the four decades since it became law, the CRA has proven to be a powerful tool for community revitalization and has encouraged trillions of dollars in lending, investment and other banking activities in low- and moderate-income communities across our nation. However, the regulatory approach to implementing CRA has become too complex, outdated, cumbersome, and subjective. Stakeholders from all perspectives have called for modernizing the current regulatory framework. Complaints with the current framework include significant administrative burden, lack of consideration for investments in areas with needs beyond a bank's assessment area, and failure to adapt the framework to advances in banking such as interstate branching and digitization of services. Others have complained about the limited opportunity for bank activities to qualify for CRA consideration. Bankers and community groups alike criticize the length of time between the issuance of CRA performance evaluations, the unwieldly length of performance evaluation reports, and the lack of transparency and clarity.

We have an opportunity to modernize the regulatory framework around CRA to better serve its original purpose and encourage more investment and banking activity supporting the

people and communities needing it most. The OCC took the first step by issuing an advance notice of proposed rulemaking (ANPR) in August 2018. The ANPR did not make any regulatory proposals. Instead, it presented 31 questions on a variety of issues and options that could reform the CRA framework, including one that asked stakeholders to tell us what issues we may have missed. The OCC solicited input from all stakeholders regarding any and all ideas and opinions about how regulators may strengthen and enhance the CRA framework.

Certain stakeholders, however, have made inaccurate claims about the purpose of the ANPR, mischaracterizing it as an effort to limit public input. To the contrary, the OCC met with over 1,000 people during outreach to discuss CRA modernization. In addition, we received approximately 1,500 letters with varied opinions and insights that, absent the ANPR, would not have been available to regulators. The OCC has shared all these comments with the other federal banking regulators, and we are working with them to jointly develop and issue a proposed rule later this year.

Our goals for strengthening CRA regulations include: 1) clarifying what counts for CRA consideration; 2) updating where CRA activity counts; 3) creating an objective means to count it; and 4) making reporting timelier and more transparent. The agencies are actively engaged in working together toward these broad goals, which will make CRA regulations work more effectively and efficiently for everyone. The proposal will be published for notice and comment, allowing the public another opportunity to provide input on the modernization of CRA regulations.

Small-dollar lending

Millions of Americans rely upon short-term small-dollar credit to make ends meet. Consumers need safe, affordable choices, and banks should be part of that solution. Banks are well-suited to offer affordable short-term small-dollar installment lending options that can help consumers find a path to more mainstream financial services without trapping them in cycles of debt.

To facilitate banks offering responsible short-term small-dollar installment loans to help meet the credit needs of their customers, the OCC published a bulletin in May 2018 setting out three core principles for these products:

- All bank products should be consistent with safe and sound banking, treat customers fairly, and comply with applicable laws and regulations.
- Banks should effectively manage the risks associated with the products they offer, including credit, operational, compliance, and reputation risks.
- All credit products should be underwritten based on reasonable policies and practices, including guidelines governing the amounts borrowed, frequency of borrowing, and repayment requirements.

The agency's bulletin also highlighted reasonable policies and practices specific to short-term small-dollar installment lending. While banks initially may not have had the infrastructure to engage in such lending, banks are purchasing loans and loan pools from online lenders, creating more liquidity for these lenders, and exploring relationships with lenders offering small dollar loans that align with the sound lending principles discussed in the bulletin.

In addition, over the course of the past year, the OCC has had discussions with several banks that are considering new small-dollar products. The CFPB's proposal to amend its Payday

Lending Rule, issued in January 2019, could accelerate interest in small-dollar products. However, as commenters noted in response to the Federal Deposit Insurance Corporation's (FDIC) November 2018 request for information, regulatory uncertainty remains. The federal banking agencies are exploring principles-based options to address this uncertainty and to encourage banks to deliver safe, fair, and less expensive short-term credit products that support the long-term financial health of their customers.

Implementation of the Economic Growth Act

The strength and vitality of the nation's financial system depend, in large part, on the ability of financial institutions, particularly community and mid-size banks, to operate efficiently, effectively, and without unnecessary regulatory burden. The Economic Growth Act provided a bipartisan framework to significantly reduce regulatory burden for small and mid-size institutions while safeguarding the financial system and protecting consumers. I am happy to report that we have made significant progress implementing the Act.

Examination cycle. In December 2018, the agencies jointly issued rules finalizing the August 2018 interim final rule changes to the agencies' examination cycles. Section 210 of the Act expanded eligibility for an 18-month examination cycle, making the extended examination cycle available to a larger number of qualifying 1- and 2-rated institutions. This change, together with parallel changes to the on-site examination cycle for U.S. branches and agencies of foreign banks, allows the agencies to better focus their supervisory resources on financial institutions that are more likely to present capital, managerial, or other supervisory issues and thus enhance safety and soundness collectively for all financial institutions.

Thrift charter flexibility. In September 2018, the OCC issued a notice of proposed rulemaking to provide greater flexibility to federal savings associations by implementing a new section of the Home Owners' Loan Act added by section 206 of the Act. This proposal would establish streamlined standards and procedures under which a federal savings association with total consolidated assets of $20 billion or less, as reported to the Comptroller as of December 31, 2017, may elect to operate with the same rights and privileges and be subject to the same duties and restrictions as a similarly located national bank but would retain its charter and existing governance framework. The comment period closed in late 2018, and the OCC hopes to issue a final rule in the near term.

Short form Call Report. Section 205 of the Act provides for reduced reporting requirements on Call Reports for the first and third quarters for institutions with less than $5 billion in total consolidated assets. This change expands the number of community institutions that can benefit from the reduced burden associated with the short form Call Report, freeing up employees and other resources to serve customers and the operational needs of the institutions. The agencies published a notice of proposed rulemaking in November 2018, and the comment period closed earlier this year. The agencies are working toward issuing a final rule shortly.

Appraisals of Residential Real Property. Section 103 of the Act provides a tailored exemption from the appraisal requirements for certain residential mortgage loans with a transaction value of less than $400,000 that are located in rural areas. The agencies received comments on the threshold for appraisals for residential real estate transactions during both the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) regulatory review process and the rulemaking process to raise the threshold for commercial real estate transactions.

After considering all of the comments and further analysis by the agencies, the agencies issued a notice of proposed rulemaking in December 2018 to increase the appraisal threshold for residential real estate transactions in order to reduce regulatory burden, particularly in rural areas, in a manner that is safe and sound and consistent with consumer protection. The comment period closed this past February. The agencies are reviewing the more than 500 comments received, with the goal of issuing a final rule later this year.

Volcker Rule: Sections 203 and 204 of the Act make changes to the statutory provisions underlying the Volcker Rule, including reducing the number of institutions subject to its requirements. These changes provide regulatory relief to institutions that do not pose the types of risks the Volcker Rule was intended to limit.[2] The agencies published a notice of proposed rulemaking in February 2019 to exclude community banks with $10 billion or less in total consolidated assets and total trading assets and liabilities of 5 percent or less of total consolidated assets from the restrictions of the Volcker Rule and to ease Volcker Rule restrictions on common names between banks and sponsored funds, consistent with the Act. The comment period closed in March 2019, and the agencies are working toward a final rule later this year.

Community Bank Leverage Ratio. The agencies issued a notice of proposed rulemaking in late 2018 to implement section 201 of the Act, which addresses the complex and burdensome process—particularly for highly capitalized community banks—of calculating and reporting regulatory capital. The proposal provides a simplified measure of capital adequacy for qualifying community banking organizations. Those qualifying community banking organizations that elect to use and comply with the community bank leverage ratio (CBLR) framework and that maintain

[2] The agencies explained in a July 2018 interagency statement that they will not enforce the Volcker Rule in a manner inconsistent with the Act.

a CBLR greater than 9 percent would be considered to have met the capital requirements for the "well-capitalized" capital category under the agencies' prompt corrective action (PCA) frameworks and would no longer be subject to the generally applicable capital rule.

Based on our analysis, setting the threshold at 9 percent in combination with the other qualifying criteria would allow most community banks to qualify for the CBLR framework, generally maintain the same amount of capital in the banking system, and exclude banks with higher risk profiles unsuitable for a non-complex reporting regime. With the 9 percent threshold and other qualifying criteria, approximately 84 percent of insured banks with total consolidated assets under $10 billion could take advantage of the CBLR framework.

As the agencies made clear in the proposal, electing to use the CBLR framework would be optional. Under the proposal, banks have the option to move in and out of the CBLR framework at any time without restrictions. However, to opt back into the CBLR framework, a bank must meet all the qualifying criteria and have a CBLR greater than 9 percent.

The proposal also includes an additional PCA framework. The agencies proposed the additional framework to allow banks the option to remain in the CBLR framework even if they no longer met the required 9 percent threshold. Doing so would give banks an additional option; they could continue to calculate a single leverage ratio, rather than being required to use the generally applicable framework, including all risk-based capital calculations, which potentially could be costly for banks to re-implement.

The comment period for the proposal closed in April. The agencies are reviewing the comments received on the proposal, with the goal of issuing a final rule by the end of this year.

Supplementary Leverage Ratio for Custody Banks. In April, the agencies issued a proposal to implement section 402 of the Act. Section 402 directs the agencies to amend the supplementary leverage ratio (SLR) to exclude qualifying deposits at a central bank for banking organizations that are predominantly engaged in custody, safekeeping, and asset servicing activities.

High-Quality Liquid Assets. Section 403 of the Act requires the federal banking agencies to amend their Liquidity Coverage Ratio (LCR) rules to treat qualifying liquid and readily-marketable, investment grade municipal securities as level 2B liquid assets. The agencies issued an interim final rule to implement section 403 in August 2018 and expect to finalize the rule this summer.

High Volatility Commercial Real Estate. In September 2018, the agencies published a notice of proposed rulemaking to implement section 214 of the Act, which limits the types of acquisition, development, and construction loans that may be considered high volatility commercial real estate exposures and subject to heightened capital requirements. The comment period closed in late 2018. The agencies are working toward a final rule early this summer.

Stress Testing. In February, the agencies published a notice of proposed rulemaking to implement changes to certain aspects of "company-run" stress testing requirements, as required by section 401 of the Act. The Act raises the minimum asset threshold for banks covered by the company-run stress testing requirement from $10 billion to $250 billion in total consolidated assets; revises the requirement for banks to conduct stress tests periodically instead of annually ; and reduces the number of required stress test scenarios from three to two. The agencies are working toward issuing a final rule this summer.

Tailoring Capital and Liquidity Requirements: The agencies recently issued proposed rules to establish risk-based categories for determining applicability of requirements under the regulatory capital rules, the LCR rules, and the proposed net stable funding ratio rules for large domestic U.S. and foreign banking organizations. These proposals build upon the agencies' existing practices of tailoring capital and liquidity requirements based on the size, complexity, and overall risk profile of banking organizations. The proposals are consistent with section 401 of the Economic Growth Act that raises the minimum asset threshold for application of enhanced prudential standards from $50 billion to $250 billion in total consolidated assets. Importantly, regulatory capital and liquidity requirements for U.S. global systemically important banks would not change under the tailoring proposal.

Supporting Responsible Innovation

In July 2018, the OCC announced its decision to consider applications for special purpose national bank charters from qualifying fintech companies engaged in the business of banking. This decision is consistent with bipartisan government efforts at federal and state levels to promote economic opportunity and support innovation and will help to provide more choices to consumers and businesses. Companies that provide banking services in innovative ways deserve the opportunity to pursue that business on a national scale as a federally chartered, regulated bank. We continue to have conversations with several such companies about the special purpose national bank charter.

A fintech company that receives a national bank charter will be subject to the same high standards of safety and soundness and fairness that all federally chartered banks must meet. As it does for all banks under its supervision, the OCC would tailor these standards based on the bank's size, complexity, and risk profile, consistent with applicable law. In addition, a fintech

company with a national bank charter will be supervised like similarly situated national banks, including with respect to capital, liquidity, and risk management requirements.

The OCC also expects a fintech company that receives a national bank charter to demonstrate a commitment to financial inclusion. The nature of that commitment will depend on the company's business model and the types of products, services, and activities it plans to provide. By applying a standard similar to that of the CRA for depository institutions, the financial inclusion commitment will help ensure that special purpose national bank charters are held to the same agency expectations of fair access to financial services and fair treatment of customers.

A special purpose national bank charter is only one option for innovative companies engaged in the business of banking. Companies may also pursue a full-service national bank charter, state charter or license where available, or partner with banks and other financial service companies. The OCC Office of Innovation is a resource available to fintechs to help them understand the opportunities available to them.

Bank Secrecy Act and Anti-Money Laundering

The BSA and AML laws and regulations exist to protect our financial system from criminals who would exploit that system for their own illegal purposes or use that system to finance terrorism. While regulators and the industry share a commitment to fighting money laundering and other illegal activities, the process for complying with current BSA/AML laws and regulations has become inefficient and costly. It is critical that the BSA/AML regime be updated and enhanced to address today's threats and better use the capabilities of modern technology to protect the financial system from illicit activity.

The OCC has taken a leadership role in coordinating discussions with the FDIC, Board of Governors of the Federal Reserve System, National Credit Union Administration, Treasury's Office of Financial Intelligence, and FinCEN to identify and implement ways to improve the efficiency and effectiveness of BSA/AML regulations, supervision, and examinations, while continuing to meet the requirements of the statute and regulations, support law enforcement, and reduce BSA/AML compliance burden. In October 2018, these agencies released a joint statement clarifying ways in which community banks with a lower BSA risk profile may be able to increase efficiency and reduce burden in their BSA/AML compliance programs by sharing BSA resources. The statement describes how these banks can effectively use collaborative arrangements to share human, technology, or other resources related to BSA compliance to reduce costs, increase operational efficiency, and leverage specialized expertise.

More recently, in December 2018, these agencies issued a joint statement encouraging banks to take innovative approaches to meet their BSA/AML compliance obligations. The statement recognizes significant potential for technological innovation to transform BSA/AML compliance. In addition to assisting banks' efforts to control their costs, innovation is increasingly necessary to counter constantly changing threats, as illicit financing methods evolve to exploit vulnerabilities in existing systems. The statement makes clear the agencies are committed to continued engagement with the private sector to modernize and innovate in their BSA/AML compliance programs. The OCC is actively engaged in discussions with banks and other stakeholders regarding ways to explore enhanced technology usage while maintaining the current strong protections for the financial system.

The OCC also has identified areas in which legislative changes could increase the impact and efficiency of BSA/AML regulation and compliance programs. The OCC generally supports

legislative changes that would reduce unnecessary industry burden and compliance costs and allow for more effective information sharing related to illicit finance. These include requiring a regular review of BSA/AML regulations to identify those that could be strengthened, refined or to reduce unnecessary burden, and providing safe harbors to promote sharing of information.[3]

Section 956 of the Dodd-Frank Act

Section 956 of the Dodd-Frank Act generally requires that the OCC, Federal Reserve, and FDIC, along with the National Credit Union Administration, the Federal Housing Finance Agency, the Securities and Exchange Commission, jointly issue regulations or guidelines that prohibit incentive-based payment arrangements that encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss, and require those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator.

Incentive compensation arrangements can be useful tools in the successful management of financial institutions. However, compensation arrangements can provide executives and employees with incentives to take imprudent risks that are not consistent with the long-term health of the institution. We have initiated discussions with the other agencies to explore principles-based options to implement section 956.

[3] For more detail, see Testimony of Grovetta N. Gardineer. U.S. Senate Committee on Banking, Housing, and Urban Affairs. November 29, 2018. https://occ.gov/news-issuances/congressional-testimony/2018/ct-2018-127-written.pdf

Additional Information

OCC's Diversity Efforts

The fulfillment of the agency's core mission of bank supervision depends on its employment of talented staff with high levels of expertise and experience. The OCC is fully committed to maintaining a competent, highly qualified workforce and recruiting the best, diverse talent available from a variety of sources. The agency is committed to maintaining an inclusive culture and workplace environment with a diversity strategy that focuses on leadership commitment, recruitment, development, retention, work-life balance, and an engaging culture. The OCC has had an agency-wide diversity strategy in place for over 10 years and regularly aligns those diversity strategic goals with the agency's strategic plan.

As of September 30, 2018, the participation rate of females in the OCC's permanent workforce was 45.1 percent, and the participation rate of minorities in the OCC's workforce was 35.1 percent. The participation rates for African Americans and Asian Americans were 17.6 percent and 9.0 percent, respectively, both above the National Civilian Labor Force (NCLF) rate. The participation rate for Hispanic Americans, at 7.3 percent, fell slightly below the NCLF rate; however, fiscal year 2018 hiring rates for Hispanic Americans exceeded the NCLF rate.

The OCC benefits greatly from the input of its seven Employee Network Groups (ENG) that advance special emphasis programs: the Network of Asian Pacific Americans; the Coalition of African American Regulatory Employees; PRIDE (the Gay, Lesbian, Transgender, and Bisexual Employees network group); the Hispanic Organization for Leadership and Advancement; The Women's Network; Generational Crossroads; and the Veterans Employee Network. These ENGs serve as a resource for mentoring and engagement, and as a collective

voice in communicating workplace concerns and providing input to management around diversity and inclusion programs and activities within the OCC. The groups hold an annual leadership forum with the Comptroller and other key agency stakeholders to align individual group objectives with agency strategic priorities pertaining to recruitment, career development, and retention.

The OCC has a robust recruitment program to attract highly qualified candidates who reflect a cross-section of the national population, particularly for its entry-level assistant national bank examiner positions. The recruitment program features ongoing partnerships with colleges, universities, banking associations, and professional affiliations. These efforts include participating in recruitment activities at Hispanic Serving Institutions, Historically Black Colleges and Universities, as well as outreach to student organizations. The OCC has also recruited on campus at minority-serving institutions and sponsored similar activities at colleges and universities with large female student bodies (60.0 percent or greater). The OCC also participates annually in a wide range of meetings, conferences, and career fairs to develop relationships and gain access to a diverse student applicant pool.

We are particularly pleased that, over the last three fiscal years (2016-2018), the OCC through the federal Pathways Internship Program has hired 36 students, of whom 41.7 percent were females and 47.2 percent were minorities. We also have hired 35 financial interns, of whom 54.3 percent were females and 31.4 percent were minorities. Over the same time frame, the agency sponsored 73 interns through its National Diversity Internship Program.[4]

[4] The OCC's National Diversity Internship Program partners with the following organizations that focus on developing opportunities for minorities and women in the industry: the Hispanic Association of Colleges and Universities; INROADS; Proxtronics Dosimetry; Wire2Net; Minority Access; and The Washington Center.

This year we also are partnering with the District of Columbia's Department of Employment Services to provide paid summer internships to more than 80 rising seniors from D.C. high schools. The internships will provide these minority students exposure to a professional workplace, career-readiness training, and greater awareness of potential career opportunities in the financial service industry and regulation.

We continue to work toward enhancing the diversity of applicant pools for manager and senior-level manager opportunities by ensuring that diversity and inclusion are foundational components in developing the pipeline for OCC leadership roles. In support of this work, executive management reviews staffing selections for pipeline positions on a weekly basis; monitors the diversity of participants in career development programs, activities and opportunities; and supports unconscious bias training for all employees.

The OCC is equally committed to the inclusion of minorities, women, and minority- and women-owned businesses at all levels of the agency's business activities. Payments to minority- or women-owned businesses represented 43.2 percent of the OCC's total contractor payments in fiscal year 2018, an 11 percent increase since 2014.

Section 308 of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) describes goals for preserving and promoting minority depository institutions. The OCC takes numerous actions to achieve these goals. For example, OCC subject matter experts provided technical assistance to minority depository institutions (MDI) on various topics, including cybersecurity, legal, accounting, compliance, and safety and soundness issues. The OCC annually hosts meetings of its Minority Depository Institutions Advisory Committee to assess the current condition of minority depository institutions, what regulatory changes or other steps the OCC may be able to take to fulfill the mandate of section 308, and other issues of

concern to OCC-supervised minority depository institutions. The OCC holds bank director workshops throughout the United States that address risk governance, credit risk, compliance risk, and other important banking issues; it encourages MDI directors to attend these workshops, waiving participation fees as an incentive. The OCC's District Community Affairs Officers consult with MDIs on community development, the CRA, and related topics, and the OCC's External Outreach and Minority Affairs staff consult with MDIs on community development financial institution certification and advise them about other federal resources that support their missions.

Review of Proposed Mergers

The OCC charters, regulates, and supervises national banks and federal savings associations (FSA). As such, we do not have a role in evaluating the proposed merger of BB&T and SunTrust, neither of which are a national bank or federal savings association.

When evaluating a proposed business combination transaction involving a national bank or federal savings association—mergers, consolidations, and certain purchase and assumption transactions—the OCC evaluates the capital level of the resulting national bank or FSA; conformity of the transaction to applicable law and regulation; the transaction's purpose and impact on the safety and soundness of the national bank or FSA; and the effect of the transaction on the national bank's or FSA's shareholders (or members, for a mutual savings association), depositors, other creditors, and customers.

In addition, when evaluating a proposed business combination under the Bank Merger Act, the OCC also considers the effect of a proposed business combination on competition; the financial and managerial resources and future prospects of the existing or proposed institutions; the probable effects of the business combination on the convenience and needs of the community

served; the effectiveness of any insured depository institution involved in the transaction in combating money laundering activities; the risk to the stability of the U.S. banking and financial system; the statutory deposit concentration limit[5] for certain interstate transactions; the statutory total liabilities concentration limit[6] for certain combinations involving large financial firms; and the performance of the applicant and the other depository institutions involved in the business combination in helping to meet the credit needs of the relevant communities, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices, in accordance with 12 USC 2903(a)(2).

Enforcement Actions

The OCC uses enforcement actions against banks as an extension of our supervisory resources to require a bank's board of directors and management to take timely actions to correct a bank's deficient practices or violations (collectively, deficiencies). Enforcement actions against banks can be either formal or informal. Informal bank enforcement actions include commitment letters, memorandums of understanding, and notices of deficiency issued under 12 CFR 30. When a bank's deficiencies are severe, uncorrected, repeat, unsafe or unsound, or negatively affect the bank's condition, the OCC may use formal bank enforcement actions. Formal bank enforcement actions typically are published or made available to the public and include consent orders, formal agreements, Gramm–Leach–Bliley Act (GLBA) agreements pursuant to 12 CFR 5.39, and civil money penalties. Except for GLBA agreements and formal agreements, formal bank enforcement actions are enforceable through the federal court system.

[5] *See*: 12 USC 1828(c)(13)
[6] *See*: 12 USC 1852

When determining the appropriate response to a bank's deficiencies, OCC exercises judgment based on the totality of the conduct and a range of circumstances. Examiners consider numerous factors including the bank's condition as reflected in its composite and component ratings; the bank's risk profile; the nature, extent, and severity of the bank's deficiencies; the extent of any unsafe or unsound practices; the board and management's ability and willingness to correct deficiencies within an appropriate time frame; and potential adverse impact to bank customers, the Deposit Insurance Fund, or the public.

Notwithstanding a bank's composite rating, the bank's financial condition, or the board and management's ability or willingness, the OCC has a presumption in favor of a formal bank enforcement action when the bank exhibits significant deficiencies in its risk management systems, including policies, processes, and control systems; there are systemic or significant violations of laws or regulations; or the board and management have disregarded, refused, or otherwise failed to correct previously identified deficiencies.

While the OCC uses our enforcement authority when warranted to ensure that a bank is accountable to remedying identified problems, bank executives and board members are ultimately accountable for the safe, sound, and compliant operation of their banks, as well as ensuring corrective actions when necessary. When assessing a bank's progress toward meeting our regulatory expectations set forth in an enforcement action, the OCC may assess civil money penalties or take other additional supervisory or enforcement action if the bank is not making sufficient and sustainable progress to remediate deficiencies. Such actions could include issuing an order that imposes business restrictions or requires the bank to make changes to its senior executive officers or members of the board of directors.

Conclusion

Thank you for the opportunity to testify before the Committee today. While the condition of the federal banking system is strong, we continue to be vigilant in monitoring economic conditions, bank activities and emerging risks. We also are advancing several priorities to ensure that banks appropriately invest to the communities that they serve and that our regulatory requirements are properly calibrated. We welcome Congress' support and interest in these activities.

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Statement by

Randal K. Quarles

Vice Chair for Supervision

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

May 16, 2019

Chairwoman Waters, Ranking Member McHenry, Members of the Committee, thank you for your time and for your invitation to testify today on the Federal Reserve's regulation and supervision of the financial system.

My visit comes 10 years, almost to the day, after the Federal Reserve released the results of its first supervisory stress tests.[1] That exercise was an invention of both urgency and necessity and a tool to move the country's largest financial institutions towards safety and stability. Many innovations from that period are now regular elements of the Federal Reserve's supervisory and regulatory work. These innovations have helped strengthen firms that were damaged by the crisis; given supervisors and the public a clearer view of risks in the financial system; and provided a solid foundation for the nation's economic recovery. Economic and market conditions have afforded us the time and opportunity to refine and improve the post-crisis regulatory framework. Now--when the financial system and economy are in good health--is the time to consolidate the insights we have gained and to better the framework we have built.

Since my last appearance before this Committee, the Federal Reserve has taken several steps to improve the framework, by integrating post-crisis innovations more fully into our supervisory processes; directing our attention and resources to the places and institutions that merit them most; and making our regulatory standards as simple, efficient, and transparent as possible. Today, I will briefly review those steps; outline the Supervision and Regulation Report that accompanies my testimony[2]; and discuss our other engagement on community, consumer, and financial stability issues, both at home and abroad.

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[1] Board of Governors of the Federal Reserve System, "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program," news release, May 7, 2009, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090507a.htm.

[2] Board of Governors of the Federal Reserve System, "Supervision and Regulation Report," May 10, 2019, https://www.federalreserve.gov/publications/files/201905-supervision-and-regulation-report.pdf.

Regulatory Tailoring and Supervision and Regulation Report

Almost a year ago, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (ERRCPA).[3] A cornerstone of this legislation was a directive to the regulatory agencies to tailor oversight of institutions to ensure that our regulations match the character of the firms we regulate, with specific congressional direction for firms between $100 billion and $250 billion in total assets. The Board's Supervision and Regulation Report centers on our recent efforts to accomplish this goal.

The core of these efforts are two sets of regulatory proposals, which better align the application of our prudential standards to the risk profiles of different banking firms.[4] Both sets derive from careful analysis and have benefitted from collaboration with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). The proposals share a common goal: to focus our energy and attention on both the institutions that pose the greatest risks to financial stability and the activities that are most likely to challenge safety and soundness.

The most recent proposal addresses prudential requirements for the U.S. operations of foreign banks. Like last year's tailoring proposal for domestic institutions, it categorizes firms according to their size, business model, and risk profile. Certain aspects differ from the domestic proposal, however, to reflect the unique characteristics of foreign banks operating in the United States, while preserving faithfulness to the principles of national treatment and

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

[4] Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on framework that would more closely match regulations for large banking organizations with their risk profiles," news release, October 31, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181031a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on regulatory framework that would more closely match rules for foreign banks with the risks they pose to U.S. financial system," news release, April 8, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm.

competitive equity. The proposal also asks for input on a number of important issues, and I look forward to reviewing the comments we receive.

These proposals are only one aspect of our efforts to implement last year's legislation. We also have been providing targeted regulatory relief, especially for community banks and other less complex organizations.

- We proposed a new interagency Community Bank Leverage Ratio to give community banking organizations a more straightforward approach to satisfying their capital requirements. State bank supervisors and others have provided thoughtful comments on our work, which we are taking into account.[5]
- We expanded community banking organizations' eligibility for both longer examination cycles and exemptions from holding company capital requirements, and we have proposed more limited regulatory reporting requirements for community banks.[6]
- We provided smaller regional bank holding companies immediate relief from annual holding company assessments and fees, stress testing requirements, and other prudential measures designed for larger institutions.[7]

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[5] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies propose community bank leverage ratio for qualifying community banking organizations," news release, November 21, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181121c.htm.

[6] 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; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies issue proposal to streamline regulatory reporting for qualifying small institutions," news release, November 7, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181107a.htm; 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. While holding companies that meet the conditions of the small bank holding company policy statement are excluded from consolidated capital requirements, their depository institutions continue to be subject to minimum capital requirements.

[7] Board of Governors of the Federal Reserve System, "Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018,

- We adjusted our regulatory capital treatment of high-volatility commercial real estate exposures and our regulatory liquidity treatment of municipal securities; exempted community banking organizations from the Volcker Rule; and clarified how collaboration among smaller institutions can help them address their BSA/AML risks.[8]

Many of the regulatory developments implement statutory changes, but they also align with a long-held Federal Reserve policy of directing more resources to the most complex institutions and the most pressing risks. To that end, I am aware that policy changes in Washington can only succeed if they are accompanied by consistent implementation in the field. Deliberate, thoughtful supervision is essential, not only to translate regulatory standards into practice, but also to monitor whether rules are working as intended. I have been visiting supervisory and examination staff across the Federal Reserve System to discuss these issues and to help ensure that the activities of field examiners and policymakers are fully aligned. I plan to continue doing so in the months ahead.

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https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf. The Board also participated in a recent proposal that would modify resolution planning requirements. See Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, "Agencies invite comment on modifications to resolution plan requirements; proposal keeps existing requirements for largest firms and reduces requirements for firms with less risk," news release, April 16, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190416a.htm.

[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; 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 invite comment on a proposal to exclude community banks from the Volcker rule," news release, December 21, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221d.htm; 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 agencies issue a joint statement on banks and credit unions sharing resources to improve efficiency and effectiveness of Bank Secrecy Act compliance," news release, October 3, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181003a.htm; see also Board of Governors of the Federal Reserve System, "Federal Reserve Board issues joint statement encouraging depository institutions to explore innovative approaches to meet BSA/anti-money laundering compliance obligations and to further strengthen the financial system against illicit financial activity," news release, December 3, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181203a.htm.

The report accompanying my testimony provides more details on these recent regulatory steps, as well as on the overall condition of the banking system. On that front, I am happy to share positive news. Banking institutions of all shapes and sizes continue to show greater loan volumes and fewer delinquencies. Capital levels remain high, and nonperforming loan ratios remain well below their five-year averages. The banking sector often reflects the health of the overall economy, and we continue to monitor emerging risks across the system to ensure institutions of all sizes can maintain their safety and soundness throughout the business cycle.

Regulatory and Supervisory Activities

Supervisory stress testing has become a potent tool for understanding these emerging risks. Its original purpose, however, was much narrower. Even after months of extraordinary public support, the financial system a decade ago remained exceedingly fragile. To relieve strain on the banking system and recapitalize the sector, markets needed credible information, which was then in short supply.[9] The first crisis-era stress test provided such insight when it was available from few other sources; it was an analysis of last resort, which marked a turning point in the crisis. As conditions changed, the role of stress testing changed as well. Today, the Comprehensive Capital Analysis and Review (CCAR) provides a forward-looking measurement of bank capital, a view of risks across the sector, and a broader understanding of the health of the financial system. As the environment in which we conduct our stress tests evolves, our stress testing processes should evolve commensurately.

In the past half year, the Board took steps to consolidate the role that stress testing plays in our work. Following the directive from the EGRRCPA, we began to transition less complex

[9] See Ben S. Bernanke, "Stress Testing Banks: What Have We Learned?" (speech at the "Maintaining Financial Stability: Holding a Tiger by the Tail" financial markets conference sponsored by the Federal Reserve Bank of Atlanta, Stone Mountain, GA, April 8, 2013), https://www.federalreserve.gov/newsevents/speech/bernanke20130408a.htm.

CCAR firms to an extended testing cycle, reflecting the lower risks they pose relative to their larger, more complex peers.[10] We published new details of our methodology and models, improving public understanding of the program and maintaining the integrity of its results.[11] We announced a new stress testing conference, inviting the broad participation, insight, and challenge that are essential for effectiveness.[12] And, while maintaining a rigorous evaluation of capital planning, we committed to addressing qualitative deficiencies at most firms through supervisory ratings and enforcement actions, rather than through a stand-alone qualitative objection.[13]

This core challenge--of keeping our supervisory processes strong, while adapting them to evolving circumstances--is not unique to stress testing. The Board, OCC, and FDIC face a similar task involving the modernization of rules implementing the Community Reinvestment Act (CRA). The value of this statute, which affirms the obligation of banks to meet the credit needs of their communities, is clear. To meet the core objective of the statute, our CRA regulatory framework and supervisory processes must evolve, adjusting to a financial sector being reshaped by technology, consolidation, and other forces. This year, we at the Fed have organized dozens of outreach meetings across the country and hosted a research symposium on

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[10] Board of Governors of the Federal Reserve System, "Federal Reserve Board releases scenarios for 2019 Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act stress test exercises," news release, February 5, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205b.htm.

[11] Board of Governors of the Federal Reserve System, "Federal Reserve Board finalizes set of changes that will increase the transparency of its stress testing program for nation's largest and most complex banks," news release, February 5, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board releases document providing additional information on its stress testing program," news release, March 28, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190328a.htm.

[12] See Randal K. Quarles, "Inviting Participation: The Public's Role in Stress Testing's Next Chapter" (speech at the Council for Economic Education, New York, NY, February 6, 2019), https://www.federalreserve.gov/newsevents/speech/quarles20190206a.htm.

[13] Board of Governors of the Federal Reserve System, "Federal Reserve Board announces it will limit the use of the 'qualitative objection' in its Comprehensive Capital Analysis and Review (CCAR) exercise, effective for the 2019 cycle," news release, March 6, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm.

this subject, in support of an interagency effort that includes the OCC's issuance of an Advance Notice of Proposed Rulemaking. We intend this effort to ensure that the CRA continues to serve low- and moderate-income communities effectively.[14]

Other recent steps support our supervisory and regulatory framework by making it simpler and more transparent. A new ratings system for large institutions aligns more closely with the supervisory feedback they receive, offering greater clarity on our expectations and the consequences of falling short.[15] A new proposal would formalize how the Board determines one company's control of another, clarifying and inviting feedback on an important concept that, among other things, determines the perimeter of the Board's regulatory authority.[16] We continue to monitor other new developments in the industry as well, like the impact of new technology on core banking services, third-party due diligence processes, cyber risk, and vendor risk management.

Effective and efficient regulation requires collaboration, both at home and abroad. We continue to engage with our regulatory counterparts overseas, through standard-setting bodies and the Financial Stability Board (FSB), where I recently began a three-year term as Chair. In establishing the FSB, the G20, led by the United States, recognized that the risks that sparked the financial crisis did not stop at national boundaries. International standards for supervision and regulation help ensure that U.S. firms can play on a level playing field in global competition,

[14] See Jerome H. Powell, "Brief Remarks" (speech at the Just Economy Conference sponsored by the National Community Reinvestment Coalition, Washington, DC, March 11, 2019), https://www.federalreserve.gov/newsevents/speech/powell20190311a.htm; Lael Brainard, "Strengthening the Community Reinvestment Act: What Are We Learning?" (speech at "Research Symposium on the Community Reinvestment Act" hosted by the Federal Reserve Bank of Philadelphia, Philadelphia, PA, February 1, 2019), https://www.federalreserve.gov/newsevents/speech/brainard20190201a.htm.

[15] Board of Governors of the Federal Reserve System, "Federal Reserve Board finalizes new supervisory rating system for large financial institutions," news release, November 2, 2018, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181102a.htm.

[16] Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on proposal to simplify and increase the transparency of rules for determining control of a banking organization," news release, April 23, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190423a.htm.

foster our own domestic financial stability, and help prevent the fragmentation of financial markets. To secure the full benefits of these standards, the work we undertake with these bodies must also evolve.[17] We must continue to evaluate the post-crisis reforms, address any adverse unintended effects, and identify and manage emerging vulnerabilities.

Conclusion

The strength of our financial system today rests on the insight, patience, and persistence of a decade's work on post-crisis reforms.[18] Those same virtues are essential to preserving that strength in the years to come. We must invite ideas and input into our regulatory and supervisory activities openly, examine them rigorously and objectively, and travel patiently and steadily wherever our analysis leads. A diligent, objective, and independent approach is the only way to remain vigilant towards new risks and ensure that our financial system can continue to address the needs of the U.S. economy. Only by thoughtfully evaluating the reforms we have made, and adjusting our approach when appropriate, can we preserve and improve the efficacy and efficiency of our regulatory framework.

Thank you. I look forward to answering your questions.

[17] See Randal K. Quarles, "Ideas of Order: Charting a Course for the Financial Stability Board" (speech at Bank for International Settlements Special Governors Meeting, Hong Kong, February 10, 2019), https://www.federalreserve.gov/newsevents/speech/quarles20190210a.htm.

[18] Board of Governors of the Federal Reserve System, "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program," news release, May 7, 2009, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090507a.htm.

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May 16, 2019

The Honorable Maxine Waters
Chairwoman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry:

The Center for American Progress ("CAP") is pleased to submit this letter and attached materials for today's hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions" in the House Financial Services Committee.

Over the last 18 months, Trump-appointed financial regulators have proposed or finalized countless rules that would weaken key elements of the post-crisis financial regulatory framework. Some of the rules implement provisions of the unwise Dodd-Frank rollback bill passed last year, while other rules go even further. These changes to bank capital requirements, stress testing, living wills, liquidity rules, the Volcker Rule, and other rules collectively weaken the resiliency of the financial system. Taxpayers, workers, families, and savers are likely to pay the price.

CAP would like to commend Chairwoman Waters for holding today's hearing. It is an important opportunity for Members to hold financial regulators accountable for their actions. Vigorous oversight is a crucial part of the Committee's agenda, which we strongly support.

Attached, please find CAP's published materials on the various deregulatory proposals advanced by Trump-appointed regulators.

Sincerely,

Gregg Gelzinis
Policy Analyst, Economic Policy
Center for American Progress

Center for American Progress

Tailoring Banking Regulations to Accelerate the Next Crisis

By Gregg Gelzinis May 16, 2019

When President Donald Trump took office, he promised to do "a big number"[1] on the Dodd-Frank Wall Street Reform and Consumer Protection Act. He also promised to give a "major haircut"[2] to this centerpiece of the U.S. response to the 2007–2008 financial crisis. Beyond signing into law the Economic Growth, Regulatory Relief, and Consumer Protection Act[3]—a 2018 bill that rolled back key pieces of Dodd-Frank—Trump has sought to keep his promise by appointing financial regulators intent on watering down major elements of financial reform.

These banking regulators—at the Federal Reserve Board of Governors, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corp. (FDIC)—have proposed or finalized a host of changes to the big-bank safeguards put in place following the 2007–2008 financial crisis. The common refrain from these regulators is that the changes should be appropriately characterized as a commonsense "tailoring" of regulation. In fact, Federal Reserve Vice Chair for Supervision Randal Quarles used the words "tailor" or "tailoring" a staggering 25 times in a single related policy speech.[4] The phrase implies the changes are neutral tweaks. When analyzing them collectively, however, it becomes very clear that they are not.

The regulatory actions, when taken together, amount to substantial big-bank deregulation and severely increase the fragility of the financial system. Some changes implement provisions to the Dodd-Frank rollback bill in concerning ways, while others go far beyond the law. The U.S. economy and taxpayers are significantly more exposed to the risks of another crash today than they were two years ago.

Living wills

The most recent deregulatory proposal, issued by the Fed and FDIC, targets banks' living wills submissions.[5] These biennial submissions to the two regulators provide a roadmap for how the bank would be wound down in an orderly fashion if it failed. If the Fed and FDIC find deficiencies upon reviewing the resolution plans, banks must rectify them in a timely manner or face more stringent regulatory safeguards.

Regulators even have the authority to break up firms if the living wills are repeatedly deficient. During the 2007–2008 financial crisis, policymakers did not have the tools or necessary information to liquidate "too big to fail" banks and shadow banks;[6] the only options were catastrophic bankruptcies or taxpayer bailouts. Through the living wills process, banks have simplified their legal structures and have better positioned capital and liquidity throughout their firms to facilitate an orderly failure, if necessary.[7]

The latest proposed rule from the Fed and FDIC would eliminate the living wills requirement for banks with between $100 billion and $250 billion in assets.[8] If a bank of this size failed, however, it would represent one of the largest bank failures in the history of the United States.[9] These are not small banks. Absent a credible living will, regulators during the next crisis would be far more likely to resort to massive bank mergers with taxpayer assistance. The proposed rule would also decrease the frequency of submissions for all banks with more than $250 billion in assets—including the largest Wall Street banks.

Initially, living wills submissions were required annually, but over time, the process shifted to the current biennial timetable. Under the proposal, banks with between $250 billion and $700 billion in assets, as well as the U.S. operations of massive foreign banks such as Deutsche Bank, would submit full plans only once every six years. The largest Wall Street banks—the eight global systemically important banks (G-SIBs)—would be required to submit a full living will once every four years. The proposal would also require banks to submit miniresolution plans halfway between full submissions. Moreover, the proposal includes a troubling provision regarding waivers for the living wills submissions: Banks can ask the Fed and FDIC to waive certain elements of the resolution plan, and only one of the two regulators has to agree to the waiver for it to be granted.[10] Put another way, if one agency rejects the waiver and one agency agrees to it, it is granted. A tie goes to the big banks, not taxpayers.

Moreover, the FDIC has begun the rule-making process for weakening the resolution plan requirements for taxpayer-insured, deposit-taking subsidiaries, also known as insured depository institutions (IDI).[11] These IDI plans are separate from the living wills. The living wills submissions cover the resolution of the entire banking conglomerate, while the IDI plans only cover the taxpayer-insured commercial banking subsidiaries.[12]

Less stringent living wills requirements decrease the likelihood of orderly failures and increase the chances that policymakers will again resort to taxpayer bailouts during the next crash.[13]

Bank capital

The lack of strong equity-capital buffers was one of the key vulnerabilities in the banking system before the financial crisis.[14] Bank capital is essentially a cushion of funding, which, unlike debt, does not need to be repaid and can therefore absorb losses. In the past decade, postcrisis efforts have substantially strengthened bank capital levels. But research shows there is more work to be done.[15] Instead of building on this progress, Trump-appointed regulators have taken steps to lower equity buffers at the largest banks in the country.

The Fed and OCC issued a proposal that would lower the capital buffers at the taxpayer-backed commercial banking units of the eight Wall Street G-SIBs by $121 billion, or 20 percent.[16] Additionally, the proposal could lead to an $86 billion reduction over time at their holding companies, as banks seek to optimize their other capital requirements.[17]

Furthermore, regulators issued a proposal that would allow banks with between $250 billion and $700 billion in assets to opt out of a new capital requirement called the accumulated other comprehensive income (AOCI) capital treatment. The AOCI requirement ensures that banks' capital levels reflect their up-to-date losses on certain assets.[18] During the crisis, banks did not have to immediately write down their capital levels when the values of certain securities were deteriorating. This treatment painted an unrealistically rosy picture of the loss-absorbing capacity at banks.[19]

Risks tend to build under the surface during strong economic times. For centuries, a damaging cycle of booms and busts has been driven, in part, by financial deregulation during positive economic times. Yet, despite clear evidence that the economy is moving toward the end of the business cycle, the Fed refused in March to activate a postcrisis capital buffer that was created to improve the loss-absorbing capacity at the largest banks during economic booms.[20] With elevated asset prices and sky-high corporate debt levels, the countercyclical capital buffer, as it is called, was designed to be activated in moments like this.[21]

These actions on bank capital leave the core banking system more vulnerable to another crash.[22]

Stress testing

The Fed proposed or finalized several changes to the bank stress-testing regime that would fundamentally weaken this important regulatory tool. Stress tests are meant to ensure banks have sufficient capital buffers to handle a severe financial shock and economic downturn, while still serving the credit needs of the real economy.[23] The first stress tests were conducted in 2009 and have played an important role in improving both the capital levels and internal capital planning capabilities at big banks.

First, the Fed proposed watering down certain assumptions used in the stress tests, which would make the tests less rigorous.[24] Banks would have to prefund only four quarters of their planned dividends instead of nine quarters of planned dividends and share repurchases. Moreover, the Fed would assume that bank balance sheets do not grow during the stress-testing time horizon, further limiting the amount of capital required by the tests.[25]

Second, the Fed proposed removing the supplementary leverage ratio (SLR)—an important capital requirement—from the stress tests.[26] The SLR does not take the riskiness of a bank's assets into account and serves as a complement to the risk-weighted capital requirements that also apply to banks.[27] This is one of the measures that prevented some Wall Street banks from initially passing the 2018 stress tests, and its removal certainly makes the tests less challenging for big banks.[28] Fed Vice Chair for Supervision Quarles even suggested the Fed may remove all leverage measures from the tests.[29] Third, the Fed is now publicly releasing detailed information on its own internal models used in the stress tests.[30] Providing this information to banks helps them game the tests and could lead to correlated risk taking, as banks adapt their balance sheets to limit their stress-testing losses based on the Fed's models. Releasing this information is akin to giving banks the tests in advance. The stress tests are supposed to shock bank balance sheets and test them in a robust manner. This change turns stress testing into a simple open book exam.

Fourth, the Fed eliminated its qualitative objection in the stress tests.[31] Under the qualitative objection, the Fed could stop big-bank shareholder distributions if the firms had deficiencies in their internal capital planning processes. The threat of this powerful tool is a major reason why banks have improved their internal controls, governance, and capabilities around capital planning.[32] And this decision runs counter to the Fed's purported desire to provide more "transparency" surrounding the tests.[33] In reality, the Fed is only advancing transparency when it serves banks. Finally, the Fed proposed reducing the frequency of stress tests from annually to biennially for banks with $100 billion to $250 billion in assets, as well as for massive foreign banks with U.S. operations of that size.[34]

These changes would make the stress tests easier for banks and reduce the utility of this vital tool. As a result, bank balance sheets and internal capabilities would be less resilient to a financial shock.

Liquidity rules

The Fed, FDIC, and OCC issued a proposed rule that would substantially reduce the liquidity requirements for banks with between $100 billion and $700 billion in assets.[35] Liquidity requirements are important safeguards to limit the chances and effects of damaging bank runs.[36] Banks should have the liquid assets necessary to

quickly meet cash demands from creditors and counterparties during a period of stress. If a bank's assets are tied up in illiquid, hard-to-sell assets, it may have to sell those assets at fire-sale prices to generate cash. Fire sales harm the bank's financial position and can have dangerous ripple effects on other firms and markets.

The regulators' proposed rule would entirely remove two important postcrisis liquidity requirements—the liquidity coverage ratio and the net stable funding ratio—for banks with between $100 billion and $250 billion in assets and would reduce these requirements by 15 percent to 30 percent for banks with between $250 billion and $700 billion in assets.[37] These changes would reduce the liquidity buffers at affected banks by $77 billion.[38]

Lower liquidity buffers at some of the largest banks in the country make it more likely that banks will resort to destructive fire sales in times of stress and increase the chances that creditors will run in the first place.[39]

Volcker rule

The five financial regulatory agencies with jurisdiction over the Volcker rule issued a proposed rule that would invite more risk into the banking system.[40] The Volcker rule prevents bank holding companies and their affiliates from making risky proprietary bets and from investing in hedge funds and private equity funds. Engaging in trading activity for the bank's own profit is highly risky and belongs outside of the core banking system, which is backed by taxpayers.

The proposal allows banks essentially to regulate their own adherence to a central provision in the Volcker rule, weakens definitions, removes certain restrictions for foreign banks, increases the size of existing loopholes, and creates new ones.[41] Despite a stated desire to advance data-driven policy, the proposal offers no data or evidence justifying the rollbacks. And recent reporting suggests Wall Street lobbying efforts have successfully convinced the regulators to make even more severe changes and reverse course on elements of the proposal banks opposed.[42]

Conclusion

Regulators call their actions regulatory "tailoring." But these actions move in one direction—weakening the big-bank regulations put in place following the financial crisis. It is deregulation, plain and simple. And the actions documented here do not cover additional recent measures, including lighter bank supervision,[43] regulatory rollbacks made by Congress that did not provide much discretion to regulators,[44] deregulation in the shadow banking sector,[45] and the dismantling of key consumer financial protections.[46]

These rules have been largely proposed or finalized on a one-by-one basis, making it easy to lose sight of the big picture. But the rules interact with and exacerbate one another, and the collective impact of these actions should trouble all Americans. Regulators are making stress in the financial system more likely while limiting the ability for banks to safely handle that stress. Regulators won't bear the burden of the next crash. That tab will be picked up, as always, by taxpayers.

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June 14, 2018

Ms. Ann Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Docket Nos. R–1604; OCC–2018–0002

Re: Federal Reserve Board and Office of the Comptroller of the Currency request for comment on a rule proposed to tailor 'enhanced supplementary leverage ratio' requirements

Dear Ms. Misback:

The Center for American Progress ("CAP") welcomes the opportunity to comment on the Federal Reserve Board's ("Fed") and the Office of the Comptroller of the Currency's ("OCC") proposed rule to revise the enhanced supplementary leverage ratio ("eSLR") requirement for certain bank holding companies and their insured depository subsidiaries. CAP is an independent nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action.

The importance of robust bank capital requirements

One of the central vulnerabilities of the financial system in the lead up to the 2007-2008 financial crisis was the lack of adequate equity capital buffers across the banking sector. The largest institutions funded their assets with far too much debt and too little capital. After the subprime housing market collapsed, losses cascaded across the financial sector and the fragility of the system was laid bare. Systemically important banks were unable to sustain losses during this period of stress without relying on unprecedented levels of government support, including taxpayer-funded bailouts. More than 500 banks[1] failed during the crisis and U.S. taxpayers spent $245 billion[2] to recapitalize the banking system, while regulators put trillions more at risk through

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emergency liquidity facilities, guarantees, and capital injections at systemically important nonbank financial companies like AIG.[3] Moreover, research from the Federal Reserve Bank of Boston underscores just how quickly capital positions at the largest banks deteriorated during the crisis.[4] Data on bank losses during the crisis does not fully capture the actual undercapitalization of the banking sector, however, as bank losses would have been even more severe had the U.S. government not stepped in to buttress the financial system.[5]

One of the main regulatory objectives following the crisis was to increase both the quality and quantity of bank capital cushions. Regulators also put an emphasis on strong leverage requirements, to complement risk-weighted capital requirements. Prior to the crisis, bank capital requirements primarily relied on regulatory risk-weighting. For these requirements, regulators make a judgement on the relative riskiness of different asset classes. At times, regulators have misjudged asset riskiness and assigned lower than appropriate risk-weights to certain assets. For example, senior tranches of mortgage backed securities and Greek sovereign debt were both treated as low risk assets. Moreover, prior to the crisis, banks found ways to game complex regulatory risk-weights through financial engineering. Banks structured assets to minimize the risk-weights while assuming similar risk exposures, in part by using derivatives and other off-balance sheet constructs.

The need for strong complementary leverage requirements—which do not factor in the real or perceived riskiness of assets—was clear in the wake of the crisis. Leverage requirements are a simple and transparent complement to risk-weighted requirements. They are not vulnerable to gaming and do not rely on the potentially-flawed determinations of regulators. In 2013, the federal banking regulators finalized a new 3% supplementary leverage ratio ("SLR") requirement for bank holding companies with at least $250 billion in assets or $10 billion in on-balance-sheet foreign exposure.[6] The SLR calculation includes both on-balance-sheet and off-balance-sheet exposures. In 2014, the federal banking regulators finalized the enhanced supplementary leverage ratio ("eSLR"), an additional 2% leverage buffer for bank holding companies with at least $700 billion in assets or $10 trillion in assets under custody.[7] The definition of a covered bank holding company was later revised to apply to banks that qualified as G-SIBs.[8] The insured depository institution ("IDI") subsidiaries of these firms are subjected to a 3% leverage buffer on top of the

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SLR, bringing the total eSLR requirements for covered firms to 5% and 6% at the holding company and IDI respectively.[9]

Current capital levels are still too low

The new SLR and eSLR requirements, in addition to the Fed's stress testing regime and strengthened risk-weighted capital requirements, have gone a long way to improve the capital positions at the largest banks in the U.S. Since the crisis, banks have added over $750 billion in common equity capital—more than double the 2009 levels.[10] But extensive research conducted by the Fed and International Monetary Fund ("IMF") demonstrate that capital levels at the largest banks are currently at the low end—or below—the socially optimal range.[11] Research from an array of academics bolsters the Fed and IMF conclusions.[12] Former Federal Reserve Governor Daniel Tarullo and former Secretary of the Treasury Timothy Geithner have both suggested that moving further into the socially optimal capital range would benefit financial stability.[13]

Put simply, current levels of capital at the largest banks are not tailored to achieve the maximum economic benefits of minimizing the chances of future financial crises, while factoring in the minor increase in bank funding costs associated with ratcheting up capital requirements.

The time to bolster bank stability is during good times and before the next adverse economic shock puts them under stress. The countercyclical capital buffer ("CCyB")—a maximum 2.5% risk-weighted capital buffer that would apply to advanced approaches banks—is a new post-crisis tool that the Fed should activate given the current economic climate. Fed Governor Lael Brainard and Federal Reserve Bank of Boston President Eric Rosengren have suggested that activating the CCyB at some point in the near future may be appropriate, and their suggestion should be followed.[14]

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[9] Ibid.

[10] Board of Governors of the Federal Reserve System, "Comprehensive Capital Analysis and Review 2017: Assessment Framework and Results" (2017), available at https://www.federalreserve.gov/publications/files/2017-ccar-assessment-framework-results-20170628.pdf.

[11] Simon Firestone, Amy Lorenc, and Ben Ranish, "An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the US" (Washington: Board of Governors of the Federal Reserve System, 2017), available at https://www.federalreserve.gov/econres/feds/files/2017034pap.pdf; Jihad Dagher and others, "Benefits and Costs of Bank Capital" (Washington: International Monetary Fund, 2016), available at https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf.

[12] For example, see Anat R. Admati, "The Missed Opportunity and Challenge of Capital Regulation" (Stanford, CA: Stanford University Graduate School of Business, 2015), available at https://www.gsb.stanford.edu/sites/gsb/files/missed-opportunity-dec-2015_1.pdf.; Simon Johnson, "The Old New Financial Risk," Project Syndicate, April 28, 2015, available at https://www.project-syndicate.org/commentary/us-bank-low-equity-ratio-by-simon-johnson-2015-04?barrier=accessreg; Morris Goldstein, Banking's Final Exam: Stress Testing and Bank-Capital Reform (Washington: Peterson Institute for International Economics, 2017); William R. Cline, The Right Balance for Banks: Theory and Evidence on Optimal Capital Requirements (Washington: Peterson Institute for International Economics, 2017).

[13] Daniel K. Tarullo, "Departing Thoughts," Board of Governors of the Federal Reserve System, April 4, 2017, available at https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm; Timothy F. Geithner, "Are We Safer? The Case for Strengthening the Bagehot Arsenal" (Washington: International Monetary Fund and World Bank Group, 2016), available at http://www.perjacobsson.org/lectures/100816.pdf.

[14] Lael Brainard, "Safeguarding Financial Resilience through the Cycle," Board of Governors of the Federal Reserve System, April 19, 2018, available at https://www.federalreserve.gov/newsevents/speech/brainard20180419a.htm; Reuters Staff, "Fed may need to adjust policy framework to respond to financial shocks -Rosengren," March 23, 2018,

Unfortunately, the eSLR proposal issued by the Fed and OCC would lower capital requirements at the most systemically important banks in the country—despite the body of research on optimal bank capital requirements, the current stage of the economic cycle, and soaring Wall Street profits.[15]

Concerns with the eSLR proposed rule

The proposed rule changes the calibration of the eSLR requirements for covered bank holding companies and their insured depository subsidiaries. Currently, bank holding companies that qualify as G-SIBs face a 5% eSLR requirement, while their IDIs face a 6% eSLR requirement. Under the proposed rule, the holding company eSLR would be the sum of 3% and one-half of the company's G-SIB surcharge. In a serious break from current practice, the IDI eSLR requirement would match the holding company requirement. The Fed and OCC claim this change would only lower holding company capital by $400 million, as other elements of the capital regime—including risk-weighted requirements and stress testing—would quickly bind. This is not the appropriate figure. Over time, banks will lower their risk-weighted assets by shifting assets towards lower risk-weights and through financial engineering. Banks could use these methods to lower capital at the holding company by around $86 billion before bumping into the new, lower eSLR requirement.[16] Moreover, Federal Reserve Vice Chairman for Supervision, Randal Quarles, suggested that the Fed may revisit the G-SIB surcharge rule.[17] Any effort to lower the G-SIB surcharge would result in an automatic decrease in the eSLR for firms, based on the proposed rule.

The more immediate impact on capital requirements, however, is at the IDI. The Fed and OCC project that capital levels at the IDI of covered bank holding companies would decrease by $121 billion—an average decrease of 20%.[18] The proposed rule eliminates the sound principle that the IDI requirements should be even stronger than the holding company requirements because taxpayers stand behind the FDIC-insured part of the firm. Such a significant decrease in capital makes it far more likely that an IDI will fail, increasing the likelihood that taxpayers suffer losses. The Fed has argued that because the capital will not leave the firm, it could be infused back into the IDI during times of stress.[19] Unfortunately, if the IDI is experiencing stress, it is highly likely that other parts of the firm will also be wavering. It may not be possible to easily infuse capital in the IDI when doing so would threaten the solvency of other subsidiaries. Strong levels of capital should be prepositioned to absorb losses at the IDI to avoid that uncertainty.

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available at https://www.reuters.com/article/us-usa-fed-rosengren/fed-may-need-to-adjust-policy-framework-to-respond-to-financial-shocks-rosengren-idUSKBN1GZ3B6.

[15] Matt Egan, "Big banks are minting money right now," *CNN*, April 18, 2018, available at http://money.cnn.com/2018/04/18/investing/big-banks-earnings-record-profits/index.html.

[16] Peter Eavis, "Washington Wants to Weaken Bank Rules. Not Every Regulator Agrees." *The New York Times*, April 24, 2018, available at https://www.nytimes.com/2018/04/24/business/dealbook/bank-rules-leverage-ratio.html?rref=collection%2Fbyline%2Fpeter-eavis.

[17] Securities Industry and Financial Markets Association, "HFSC Hearing with Fed's Quarles," April 17, 2018, available at https://www.sifma.org/resources/general/hfsc-hearing-with-feds-quarles/.

[18] Jeff Stein, "Fed advances plan to weaken post-financial-crisis rule for biggest banks," *The Washington Post*, April 24, 2018, available at http://www.washingtonpost.com/news/wonk/wp/2018/04/24/fed-advances-plan-to-weaken-post-financial-crisis-rule-for-biggest-banks/.

[19] Ibid.

This proposed rule has a particularly concerning impact on custody banks subjected to the eSLR. The two custody banks that currently face the eSLR both have a 1.5% G-SIB surcharge. The proposed rule would therefore change their current eSLR requirements from 5% and 6% at the holding company and IDI, respectively, to 3.75% for the holding company and IDI. This is a steep drop in leverage requirements for institutions collectively holding over $65 trillion in assets under custody and administration.[20] Custody banks are critical to the plumbing of the financial sector and a major custody bank failure could have catastrophic consequences. The proposed rule is not the only proposal that would impact leverage requirements for custody banks. Section 402 of S.2155—which was signed into law by President Trump in May—directs regulators to exclude central bank deposits from the denominator of the SLR for banks predominantly engaged in custody banking.[21] This change violates the principle of the leverage ratio by essentially assigning this specific category of assets a 0% risk-weight. The combined effect of the eSLR proposed rule and the legislative change to the SLR calculation would be a precipitous drop in custody bank capital. Not only would the topline leverage requirements fall significantly, but the calculation to reach those topline requirements would be less stringent.

This proposed rule has also received an unprecedented level of opposition from current and former regulators. The Federal Deposit Insurance Corporation ("FDIC") refused to join the Fed and OCC in issuing the proposed rule due to the negative impact on bank capital levels.[22] In addition, current Fed Governor Lael Brainard dissented when the Fed voted to issue the proposed rule—the first such dissent on a regulatory proposal since the Fed started releasing such votes publicly.[23] Former FDIC Chair Sheila Bair and Vice Chair Tom Hoenig have also publicly opposed the proposed rule, warning that it increases the likelihood of another financial crisis.[24]

Recommendations

There is ample evidence that capital levels are too low at the largest banks in the country—especially given the economy's current position in the business cycle—and regulators should rectify this problem instead of exacerbating it. Both leverage and risk-weighted capital requirements should be significantly increased at the most systemic banks in the country.

Regulators have noted that leverage requirements are currently the binding capital requirement for several G-SIBS. Shifting the binding constraint to risk-weighted requirements is one of the

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[20] Calculation based on U.S. Securities and Exchange Commission, "Form 10-K for State Street Corp." (2017), available at http://investors.statestreet.com/Cache/392404025.PDF?O=PDF&T=&Y=&D=&FID=392404025&iid=100447; U.S. Securities and Exchange Commission, "Form 10-K for The Bank of New York Mellon Corp." (2017), available at https://www.bnymellon.com/_global-assets/pdf/investor-relations/form-10-k-2017.pdf.

[21] *Economic Growth, Regulatory Relief, and Consumer Protection Act*, S.2155, 155 Cong. 2 Sess. (Government Printing Office, 2017).

[22] Martin J. Gruenberg, "Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation (FDIC), Notice of Proposed Rulemaking on Supplementary Leverage Ratio Issued by the Federal Reserve and OCC," Federal Deposit Insurance Corporation, April 11, 2018, available at https://www.fdic.gov/news/news/speeches/spapr1218.html.

[23] Board of Governors of the Federal Reserve System, "Board Votes," April 10, 2018, available at https://www.federalreserve.gov/aboutthefed/boardvotes.htm.

[24] Thomas M. Hoenig and Sheila C. Bair, "Relaxing Bank Capital Requirements Would Risk Another Crisis," The Wall Street Journal, April 26, 2018, available at https://www.wsj.com/articles/relaxing-bank-capital-requirements-would-risk-another-crisis-1524784371.

reasons regulators have provided for advancing this proposed rule.[25] If regulators wish to achieve that goal, they should increase risk-weighted requirements for G-SIBs instead of eroding leverage requirements.

Furthermore, if the Fed and OCC do move forward with this rulemaking, the stronger eSLR requirement for a covered bank holding company's IDI should be reinstated. The leverage requirements for the portion of the firm with taxpayer-backed liabilities should be higher than those for the holding company. If the IDI fails, taxpayers are on the hook. Stronger capital requirements limit the chances of that occurrence. The Fed has argued that because the capital released from the IDI will remain within the company, it could be redeployed to the IDI if it's in trouble. If the IDI is experiencing financial trouble, it is likely that other parts of the firm are also experiencing stress. It may not be possible for the company to redeploy significant capital to the IDI in a stressed environment, making it important to preposition strong capital levels. Regulators should maintain the 1 percentage point disparity between eSLR requirements for the holding company requirements and IDI.

Finally, the eSLR proposal must account for legislative changes that revised the calculation of the SLR for banks predominantly engaged in custody banking. Regulators should ensure that G-SIB custody banks do not receive both the S.2155 SLR calculation treatment and the eSLR proposed rule reduction in capital levels. Both changes together would dangerously deplete capital levels at G-SIB custody banks.

While considering changes to this proposed rule, regulators should keep in mind the worker who will lose her job, the family that will lose their home, and the retiree whose hard-earned savings will be wiped away in the next financial crisis. Amidst high bank profits and building risk in the financial sector, it is unwise to make such a crisis more likely.

Any questions on this comment letter or on related issues should be directed to Gregg Gelzinis at ggelzinis@americanprogress.org.

Sincerely,

Gregg Gelzinis
Research Associate, Economic Policy
Center for American Progress

[25] Randal K. Quarles, Testimony before the Committee on Banking, Housing, and Urban Affairs, "The Semiannual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System," April 19, 2018, available at https://www.banking.senate.gov/imo/media/doc/Quarles%20Testimony%204-19-18.pdf.

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Docket Nos.: R-1627; OCC-2018-0037; R-1628

RE: Proposed changes to applicability thresholds for regulatory capital and liquidity requirements; and prudential standards for large Bank Holding Companies and Savings and Loan Holding Companies

Dear Sirs/Madams:

The Center for American Progress ("CAP") welcomes the opportunity to comment on the proposed changes to applicability thresholds for regulatory capital and liquidity requirements and prudential standards for large Bank Holding Companies ("BHCs") and Savings and Loan Holding Companies ("SLHCs").[1] CAP is an independent nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action.

The proposed rules would substantially weaken certain safeguards put in place following the 2007-2008 financial crisis for many of the largest banks in the country. The class of U.S. banks

[1] This comment letter was adapted from: Gregg Gelzinis, "Danger lurks in latest deregulatory push," *American Banker*, November 13, 2018, available at https://www.americanbanker.com/opinion/danger-lurks-in-latest-deregulatory-push.

impacted by the various regulatory rollbacks included in the proposed rules—those with between $100 billion and $700 billion in assets—collectively hold almost $3 trillion in assets.[2] This class of firms is systemic. The failure of one or many, especially during a period of broader stress in the financial system, could threaten financial stability and trigger or aggravate a financial crisis. To underscore this point, during the crisis they collectively received nearly $60 billion in Troubled Asset Relief Program ("TARP") bailout funds.[3] It is important to keep in mind that these are not community banks. The failure of one of these institutions would represent one of the largest bank failures in U.S. history. Out of the 5,700 banks in the U.S., only eight banks are considered more systemically important than the class of banks impacted by the regulatory rollbacks in this rule.

Some elements of the proposal implement provisions of S.2155, the financial deregulation bill signed into law by President Trump earlier this year, while others go even further.[4] The changes to stress testing, capital requirements, and liquidity rules would reduce the banking sector's ability to withstand bouts of stress in the financial system, elevate the possibility of debilitating bank runs, and increase the chances of another financial meltdown.

Regulators should finalize a rule that applies enhanced prudential standards to SLHCs, but removes the proposed rollbacks of capital requirements, liquidity rules, and stress testing. Regulators must consider ways to strengthen, not weaken, big bank safeguards.

Liquidity Requirements

The financial crisis demonstrated the need for robust bank liquidity requirements.[5] Buffers of liquid assets, which can be easily turned into cash, are crucial for mitigating the potential fire-sale risks posed when creditors head for the doors. If banks don't have adequate liquid assets to meet their cash and collateral demands during a period of stress, they have to resort to damaging fire-sales of illiquid assets like loans and certain securities. Fire-sales at these banks would transmit stress to other financial institutions with similar assets, increase costs in funding markets, and threaten the solvency of the bank itself. Moreover, creditors are more likely to pull their cash and run in the first place when they think a bank might not have the liquid assets necessary to pay them back. During the crisis, banks used far too much short-term debt, e.g. repurchase agreements and commercial paper, to fund the longer-term and less-liquid assets on (and off) their balance sheets. This was a particularly acute problem at the largest investment

[2] National Information Center, "Holding Companies with Assets Greater Than $10 Billion," available at https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx.
[3] ProPublica, "Bailout Recipients," available at https://projects.propublica.org/bailout/list/index.
[4] *Economic Growth, Regulatory Relief, and Consumer Protection Act*, S. 2155, 115 Cong., 2 sess. (Government Printing Office, 2018), available at https://www.congress.gov/bill/115th-congress/senate-bill/2155.
[5] Daniel K. Tarullo, "Liquidity Regulation," Board of Governors of the Federal Reserve System, November 20, 2014, available at https://www.federalreserve.gov/newsevents/speech/tarullo20141120a%20.htm.

banks, including Lehman Brothers, Merrill Lynch, and Bear Stearns, but also applied to flighty uninsured deposits and other short-term debt instruments at commercial banks.[6]

Today, large banks are subjected to new liquidity rules and have significantly improved their liquidity positions compared to the pre-crisis era.[7] The two key liquidity requirements developed following the crisis are the liquidity coverage ratio ("LCR"), which has been finalized, and the net stable funding ratio ("NSFR"), which has yet to be finalized. The LCR requires banks to maintain a buffer of high-quality liquid assets to meet 30 days of cash outflows during a period of stress. The full 30-day LCR applies to banks with more than $250 billion in assets or $10 billion in on-balance sheet foreign exposure, while a less stringent version requiring a 21-day buffer applies to banks with $100 billion to $250 billion in assets.[8] The NSFR takes a longer view and requires banks to better align their funding profile with the liquidity of their assets. The more illiquid a bank's assets, the more stable funding is required. Like the LCR, the NSFR requirement, as proposed, tailors the requirement. The full NSFR would apply to banks with more than $250 billion in assets or $10 billion in on-balance foreign exposure, while a less stringent requirement would apply to banks with $100 billion to $250 billion in assets.

The most concerning element of the proposal would lower these liquidity requirements for banks with between $100 billion and $700 billion in assets. Banks with between $100 billion and $250 billion in assets would no longer face the modified LCR[9] and, once finalized, the modified NSFR.[10] The Fed estimates that this change would reduce the liquidity buffers at these banks by $34 billion. This change implements part of the unwise rollbacks in S.2155. But unlike S.2155, regulators didn't stop there. They also proposed a 15%-30% reduction in the LCR and NSFR requirements for banks with between $250 billion and $700 billion in assets.[11] This would reduce their liquidity buffers by an estimated $43 billion.

Fed Vice Chairman for Supervision Quarles argues that the proposed liquidity changes would only reduce buffers of high-quality liquid assets by 2%-2.5%.[12] This statistic does not tell the

[6] Jonathan D. Rose, "Old-fashioned deposit runs" (Washington, D.C.: Finance and Economics Discussion Series, Board of Governors of the Federal Reserve System, 2015), available at https://www.federalreserve.gov/econresdata/feds/2015/files/2015111pap.pdf.
[7] Janet Yellen, "Keynote address from Janet Yellen on the tenth anniversary of the financial crisis," Brookings Institution, November 19, 2018, available at https://www.brookings.edu/research/keynote-address-from-janet-yellen-on-the-tenth-anniversary-of-the-financial-crisis/.
[8] The prior enhanced prudential standards asset threshold under Dodd-Frank was $50 billion. S.2155 moved that threshold up to $250 billion and gave the Fed the authority to reapply enhanced prudential standards to banks with between $100 billion and $250 billion in assets.
[9] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, "Federal banking regulators finalize liquidity coverage ratio," Press Release, September 3, 2014, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140903a.htm.
[10] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, "Agencies propose net stable funding ratio rule," Press Release, May 3, 2016, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20160503a.htm.
[11] Banks that meet the $75 billion in cross-jurisdictional activity threshold would still face the full LCR and NSFR.
[12] Randal K. Quarles, "Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations by Vice Chairman for Supervision Randal K. Quarles," Board of Governors of the Federal Reserve

whole story. Vice Chairman Quarles is referring to the reduction of high-quality liquid assets across all firms subject to stress testing, currently those above $100 billion in assets. Importantly, this figure includes G-SIBs, which are not impacted by the proposal. Analyzing the aggregate reduction in liquid asset buffers across all large banks ignores the acute depletion at banks with $100 billion to $700 billion in assets. Cutting the liquidity requirements at all large banks uniformly by 2%-2.5%, while still unwise, would have a very different impact compared to this proposal's targeted 15%-30% reduction among banks with $100 billion to $700 billion in assets. The large dilution of the liquidity requirements at these firms significantly increase their chance of failure during a period of stress in the financial system. If one or multiple of these interconnected firms failed, it would place a serious strain on the banking system—including at the G-SIBs not directly impacted by this rule.

Accumulated Other Comprehensive Income ("AOCI") opt-out

The proposed rule would also allow banks with between $250 billion and $700 billion in assets to opt-out of a requirement that ensures their capital levels reflect the unrealized losses and gains of certain securities, including available-for-sale debt portfolios.[13] This requirement stems directly from lessons learned during the financial crisis, when bank capital levels did not necessarily reflect the mark-to-market losses banks experienced on their available-for-sale portfolios.[14] This capital accounting treatment painted an unrealistically rosy picture of banks' loss absorbing capacity. Regulators estimate that this change would make the capital positions at these banks look $5 billion better, without actually improving their capacity to absorb losses. As interest rates continue to rise, and the fair value of debt securities in the available-for-sale portfolio decreases, the $5 billion figure will also rise. Moreover, during a period of instability in the financial system similar to 2007-2008, it is clear the impact on reported capital would be significantly higher than the current $5 billion impact presented by regulators. This is certainly not the right statistic to use when evaluating this proposal and clearly regulators are rejecting some of the lessons learned during the crisis. At the very least, regulators should provide the public with the projected impact of this change on the reported capital ratios of these banks under a severely adverse scenario.

The AOCI opt-out is simply another data point in a concerning trend towards weaker big bank capital requirements over the past two years. Other proposed rules advanced by regulators would significantly reduce G-SIB leverage requirements[15] and would weaken the assumptions used in the stress tests[16], leading to a net reduction in capital at the largest banks in the country.

System, October 31, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/quarles-opening-statement-20181031.htm.

[13] Banks that meet the $75 billion in cross-jurisdictional activity threshold would not be allowed to opt-out.

[14] Lael Brainard, "Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations by Governor Lael Brainard," Board of Governors of the Federal Reserve System, October 31, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20181031.htm.

[15] Board of Governors of the Federal Reserve System, "Rule proposed to tailor 'enhanced supplementary leverage ratio' requirements," Press Release, April 11, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm.

[16] Board of Governors of the Federal Reserve System, "Federal Reserve Board seeks comment on proposal to simplify its capital rules for large banks while preserving strong capital levels that would maintain their ability to

These efforts to water down the loss-absorbing equity buffers at big banks come at a time when regulators should be increasing capital requirements. Significant research shows that capital requirements are at or below the bottom of the socially optimal range and the costs of having too little capital are substantially higher than the costs associated with too much capital.[17] Beyond this line of research, the economy's position in the business cycle warrants an increase in capital. As highlighted by the Fed's recently released financial stability report, nonfinancial sector leverage is near its 20-year high, credit quality has deteriorated, and valuations across many asset classes are stretched.[18] In the 9th year of the post-crisis economic expansion, risks are developing under the surface. Now is the time to act in a prudent, countercyclical manner by tightening bank capital requirements and other safeguards. Loosening them, as envisioned in these proposed rules, would be dangerously procyclical.

Stress Testing

In addition, the proposal would implement another provision in S.2155 by reducing the frequency of stress tests for banks with between $100 billion and $250 billion in assets from annually to every other year. The stress testing regime, which helps determine whether banks have enough equity capital to absorb losses during a severe economic downturn, has proved to be a powerful regulatory tool over the past decade. Earlier this year, the Fed set forth a concerning proposal that would loosen certain assumptions used in the stress tests.[19] The Fed's proposal would reduce the number of quarters of required prefunded dividends and remove the assumption that a bank's balance sheet increases, instead holding it constant. Those adjustments, if finalized, would lower the required capital buffers for banks of this size. Further eroding the stress testing regime for these banks by reducing the frequency is a mistake. When analyzing this decrease in bank oversight, and other changes in the proposal, it's important to remember that these are not small community banks. They are among the top 25 largest U.S. banks, out of more than 5,700 in the country, and the failure of one of them would constitute one of the largest bank failures in U.S. history.

Stress tests help provide creditors and the broader public a sense of confidence in the stability of the banking system. If the banking system experienced turmoil in a year that these banks were not stress tested, creditors and the public may feel that they don't have an up-to-date picture of the banks' health. If a bank of this size, like Countrywide, was stress tested in 2006, would creditors have trusted those results a year and a half later? This could exacerbate a panic and lead to more flighty creditors, stressing the liquidity positions of these banks. For this reason,

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lend under stressful conditions," Press Release, April 10, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm/.

[17] See for example, "Simon Firestone, Amy Lorenc, and Ben Ranish, "An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the US" (Washington: Board of Governors of the Federal Reserve System, 2017), available at https://www.federalreserve.gov/econres/feds/files/2017034pap.pdf.

[18] Board of Governors of the Federal Reserve System, "Financial Stability Report" (Washington, D.C.: 2018), available at https://www.federalreserve.gov/publications/files/financial-stability-report-201811.pdf/.

[19] Board of Governors of the Federal Reserve System, "Federal Reserve Board seeks comment on proposal to simplify its capital rules for large banks while preserving strong capital levels that would maintain their ability to lend under stressful conditions," Press Release, April 10, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.

the changes to stress testing frequency for these banks could compound the risk of the liquidity changes in this proposal.

Another problem with this change is that bank capital requirements will be determined, in part, through the stress tests as implemented by the stress capital buffer proposal.[20] Outdated projected loss figures would lead to stress capital buffer requirements that don't adequately reflect the current potential vulnerabilities of the bank's balance sheet in years without stress tests. Banks may also use this to their advantage by increasing their risk-taking during years in which they aren't stress tested.

The Fed has the authority to continue annual stress testing for these firms, as S.2155 calls for these firms to be stress tested "periodically".

In addition, firms with $100 billion to $250 billion in assets would no longer engage in company-run stress testing if this proposal is finalized. Distinct from the supervisory stress tests, the tests performed by companies themselves—using scenarios provided by regulators—have improved the internal risk management capabilities of large banks. Prior to the passage of S.2155, banks above $10 billion in assets were subject to this requirement. S.2155 raised the asset threshold 25x to $250 billion but gave the Fed authority to reapply this standard to banks above $100 billion in assets. The Fed imprudently has not exercised this authority and the proposal keeps the $250 billion threshold for company-run stress testing in place.[21]

Regulatory Categories

The proposal would create a new four-tier framework for applying certain prudential regulations to banks and SLHCs of different sizes and risk profiles. Category I includes firms that qualify as U.S. G-SIBs; Category II includes firms with more than $700 billion in assets or more than $75 billion in cross-jurisdictional activity; Category III includes firms with more than $250 billion in assets or that trigger certain nonbank asset, wholesale funding, or off-balance sheet exposure thresholds; and Category IV includes firms with between $100 billion and $250 billion in assets. These new categories would replace the current three-tier framework for banks above $100 billion in assets.[22]

Setting aside the prudent decision to integrate SLHCs, the four new categories do not meaningfully change the different regulatory groupings of banks compared to the current three-tier structure. In essence, only two banks are located in a different grouping than they are today.[23] Category IV banks are the same as the current $100 billion - $250 billion in assets tier, with one addition; Category III banks are the equivalent of advanced approaches firms that do

[20] Ibid.
[21] Currently, no banks would trigger the Category III non-asset thresholds.
[22] Today, banks above $100 billion are generally grouped into 3 tiers for regulatory purposes: (i) G-SIBs, (ii) $250 billion+ in assets or $10bn+ in on-balance sheet foreign exposure, and (iii) banks with $100 billion - $250 billion in assets.
[23] Northern Trust is now in a category of its own (Category II) and American Express (Category IV) is no longer in a tier with "advanced approaches" firms.

not qualify as G-SIBs, with two subtractions; Category II is occupied by only one bank, which is currently an advanced approaches bank that does not qualify as a G-SIB; and Category I consists of G-SIBs. To underscore how little the proposed categories change the current regulatory tiers, only one bank is in a different tier than would be dictated by its asset size. That is to say the proposed non-asset metrics, while receiving much rhetorical attention, are only triggered by one bank. Ironically, that is one fewer bank than currently triggers the on-balance sheet foreign exposure metric used to complement asset-size thresholds under the existing three-tier framework. For all of the misguided rhetoric opposing asset-size thresholds, it is more predictive of regulatory tier under the proposal than it is under today's framework.

The proposed categories are less important than the stringency of regulation that applies to banks within the categories. Regulators may not have meaningfully changed the groupings of banks, but as this comment letter outlines, regulators did roll back many important post-crisis rules that apply to banks in certain categories.

Conclusion

The Fed should finalize a rule that applies enhanced prudential standards to SLHCs and rescind the proposed rules' provisions that weaken capital requirements, liquidity rules, and stress testing. Unfortunately, regulators are unlikely to do so and have made it clear that more deregulatory rules are on the way. The Fed announced that new rules for large foreign banks and for living wills requirements will be proposed in the near future.[24]

It's important consider the cumulative impact of these and other financial rollbacks. Regulators have already proposed to lower big bank leverage requirements[25], weaken the Volcker Rule[26], loosen certain stress testing assumptions, and have released all systemically important nonbanks from enhanced oversight.[27] To make matters worse, risks are currently building in the financial system as the economy moves towards the end of the economic cycle.[28] Policymakers should be issuing proposals that build on the progress of financial reform.[29] Instead, workers, families,

[24] Randal K. Quarles, "Notices of proposed rulemaking to tailor prudential standards," Memorandum, October 24, 2018, available at https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20181031.pdf.
[25] Gregg Gelzinis, "This is not the time to loosen rules on bank capital," *MarketWatch*, May 2, 2018, available at https://www.marketwatch.com/story/this-is-not-the-time-to-loosen-rules-on-bank-capital-2018-05-02.
[26] Gregg Gelzinis, "Hollowing out the Volcker Rule" (Washington, D.C.: Center for American Progress, 2018), available at https://www.americanprogress.org/issues/economy/reports/2018/10/03/458638/hollowing-volcker-rule/.
[27] Gregg Gelzinis, "CAP Statement on FSOC's Vote to Deregulate Prudential Financial: Decision 'Decreases the Resiliency of the U.S. Financial System'" *Press Release*, October 17, 2018, available at https://www.americanprogress.org/press/statement/2018/10/17/452160/statement-cap-statement-fsocs-vote-deregulate-prudential-financial-decision-decreases-resiliency-u-s-financial-system/.
[28] Gregg Gelzinis, "It's time for the Fed to activate safeguards against financial bubbles," *MarketWatch,* August 2, 2018, available at https://www.marketwatch.com/story/its-time-for-the-fed-to-activate-safeguards-against-financial-bubbles-2018-07-31.
[29] Gregg Gelzinis, Andy Green, and Marc Jarsulic, "Resisting Financial Deregulation" (Washington, D.C.: Center for American Progress, 2017), available at https://www.americanprogress.org/issues/economy/reports/2017/12/04/443611/resisting-financial-deregulation/.

savers, and taxpayers will bear the burden of policymakers' decision to move in the opposite direction.

Sincerely,

Gregg Gelzinis
Research Associate
Center for American Progress

Center for American Progress

ECONOMY

STATEMENT: Federal Reserve's Refusal to Activate Countercyclical Capital Buffer Leaves Banking System Vulnerable, CAP's Gregg Gelzinis Says

Date: March 6, 2019
Contact: Allison Preiss
Email: apreiss@americanprogress.org

Washington, D.C. — Today, the Federal Reserve Board voted against activating the countercyclical capital buffer, a loss-absorbing equity cushion that would apply to the largest banks in the country. **Gregg Gelzinis,** policy analyst at the Center for American Progress, released the following statement:

> The Fed's refusal to activate the countercyclical capital buffer completely ignores the lessons learned from the 2007–2008 financial crisis. During positive economic times, as risks develop under the surface, regulators should strengthen financial safeguards to bolster the banking system in advance of the next economic downturn.
>
> As noted in the Fed's own financial stability report released in November, valuations across many asset classes are stretched, corporate leverage is near a 20-year high, and riskier firms have been increasing their debt the most. Now is the time for regulators to enhance the resiliency of the banking sector. Instead, the Fed and Trump-appointed financial regulators in other agencies have chipped away at the postcrisis regulatory framework. They have watered down bank capital requirements, liquidity rules, stress testing, the Volcker Rule, and more.

These actions make the financial system more fragile, rather than putting it in a better position to deal with the next economic downturn.

Related resources:

- It's time for the Fed to activate safeguards against financial bubbles by Gregg Gelzinis (Marketwatch op-ed)
- The Limitations of Monetary Policy as a Financial Stability Tool by Marc Jarsulic and Michael Madowitz

For more information on this topic or to speak with an expert, contact Allison Preiss at apreiss@americanprogress.org or 202.478.6331.

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Hollowing Out the Volcker Rule

How Regulators Plan to Undermine a Pillar of Financial Reform

By Gregg Gelzinis October 3, 2018

This May, the five financial regulators tasked with implementing the Volcker Rule issued a proposal that would severely undermine its safeguards and protections.[1] The Volcker Rule—Section 619 of the Dodd-Frank Act—was finalized by regulators in 2013 and took effect in 2015; it is one of the most important elements of the federal government's response to the 2007–2008 financial crisis.[2] The provision bans banks and their affiliates from engaging in proprietary trading—highly risky speculative trading for their own profit—and severely restricts their ability to own, invest, or sponsor hedge funds and private equity funds. It also targets conflicts of interest and places restrictions regarding these highly risky activities on certain nonbank financial institutions, which are designated as systemically important by the Financial Stability Oversight Council.[3] The Volcker Rule essentially ensures that banks with access to the federal safety net—namely the Federal Reserve's discount window and federal deposit insurance—are oriented toward client-focused activities that bolster the real economy, which actually produces goods and services.

The financial crisis demonstrated that highly risky trading activities and hedge fund and private equity investments can cause rapid and large-scale losses at banks, thereby threatening financial stability.[4] These activities also lent themselves to significant conflicts of interest between banks and their customers.[5] The 2013 final rule implementing the Volcker Rule statute, while not perfect, took meaningful steps to ensure that banks and their affiliates no longer engaged in these highly risky activities.

The proposed rewrite would strip away many important protections included in the original 2013 final rule. U.S. Securities and Exchange Commission (SEC) Commissioner Kara Stein appropriately summed up the impact of the changes included in the proposed rule: "[T]his proposal cleverly and carefully euthanizes the Volcker Rule."[6] The changes are not tweaks. Under the guise of streamlining the rule, the rewrite drives large and irreparable holes in the limits established by statute. By expanding exemptions, watering down definitions, eliminating certain compliance requirements, and transferring some oversight to the banks themselves, regulators are inviting more risk into the banking system.

The overwhelming thrust of these changes would be a mistake, even when considered in isolation; but they are particularly dangerous when considered in conjunction with other actions taken by Trump-appointed regulators and his allies in Congress. In May, President Donald Trump signed a Dodd-Frank rollback bill deregulating 25 of the largest 38 banks in the United States and making other changes that chip away at the regulatory standards that apply to the largest Wall Street banks.[7] Regulators have issued a slew of proposed rules to reduce financial market protections; for example, bank regulators have proposed to reduce the loss-absorbing capital buffers at the largest banks in the country and have proposed to weaken the annual bank stress tests by loosening some of the assumptions they use.[8] The Commodity Futures Trading Commission (CFTC) has proposed rolling back some post-crisis rules governing the derivatives market; the SEC has weakened certain rules that apply to asset management firms; and the Financial Stability Oversight Council is close to releasing the final systemically important nonbank financial company from enhanced oversight.[9] Therefore, the Volcker Rule changes will introduce more risk into the banking system and financial markets just as policymakers are making the financial system less resilient. In addition, several important financial safeguards mandated by the Dodd-Frank Act have yet to be finalized, including the SEC's derivatives oversight regime, restrictions on incentive-based compensation arrangements, and the CFTC's position limits on speculative commodity holdings. To paint an even bleaker picture, all of these actions come at a time when the economy is moving toward the end of a business cycle—a period during which risks tend to build in the financial sector.[10]

The complete lack of evidence offered by regulators to justify the rewrite is striking.[11] Commercial banking profits are at all-time highs, and profits at the largest Wall Street investment banks have eclipsed precrisis levels.[12] If the Volcker Rule was significantly hampering banks' ability to operate effectively, or if the compliance burden outweighed the profitability of trading activities, it stands to reason that those deleterious impacts would show up on banks' income statements. They have not.

Some banks have complained that the Volcker Rule has negatively affected market liquidity, making it costlier for buyers and sellers to transact in the marketplace.[13] If market liquidity were meaningfully impaired, those increased costs would, in turn, serve as a drag on economic growth. However, countless studies by academics and regulators have analyzed liquidity and found that key liquidity metrics are well within historical norms—and in some cases better than precrisis levels.[14] In fact, after Congress required the SEC to take a close look at market liquidity, the SEC—like the multitude of academic studies—found no reason for concern.[15] To the contrary, its report found that in recent years, trading costs have decreased in many asset classes.[16]

Volcker Rule critics have also claimed that the Volcker restrictions would hamper bank lending, but again, the data have shown the opposite to be true. Since post-crisis financial measures were put in place, bank lending has grown at a healthy rate.[17] What some critics have ignored is the fact that, due to financial stability safeguards

like the Volcker Rule and other post-crisis reforms, banks are more likely to continue providing financial intermediation—including client-focused capital markets services—throughout the economic cycle. The proposed rule itself offers no data-driven evidence to back up the proposed changes. On 30 separate pages of the proposal, regulators merely cite their experience implementing the rule as the reason why the changes are appropriate.[18] Over the past three years, they have collected troves of trading data; yet they do not provide any such data in order to make the case for these changes.[19] Indeed, regulators claim that the data they have collected "have provided valuable insights into the effectiveness of the 2013 final rule."[20] If the data do indeed provide valuable insights into the impact and effectiveness of the 2013 final rule, regulators must make these data public as part of the rule-making record.

The lack of data justifying the proposed changes raises questions as to whether the proposal is opaque in order to hide its true effects, or whether the regulators were simply rushing to get the proposal out the door. It also raises significant questions regarding its compliance with the Administrative Procedure Act.[21] Regulators must provide the public with a meaningful opportunity to comment and with substantial evidence justifying the proposed regulation. Otherwise, due to the rule's arbitrary and capricious nature, it could be struck down in the courts. Without any data or evidence in the Volcker Rule proposal, it is next to impossible for the public to meaningfully evaluate it.[22]

The Volcker Rule final regulation of 2013 made significant progress toward reducing risk, eliminating conflicts of interest, and strengthening the financial system—statutory goals that were set out by Congress in the Dodd-Frank Act as articulated by former President Barack Obama, former Federal Reserve Chairman Paul Volcker, and congressional co-authors Sen. Jeff Merkley (D-OR) and former Sen. Carl Levin (D-MI). In response, banks have wound down their stand-alone proprietary trading desks and, based on limited public data, appear to be making trading profits instead from client-centric permitted activities like market-making and underwriting—not the price appreciation of assets.[23]

At the same time, the 2013 Volcker Rule regulation is not without its flaws. If the current regulators genuinely wanted to strengthen the existing rule, there are several ways in which it could be improved.[24]

First, they could mandate greater transparency related to compliance with and enforcement of the Volcker Rule.[25] Public release of bank trading metrics collected by regulators, on a delayed basis, would enable academics, analysts, and others to better understand how banks are complying with the rule. To date, only one penalty has been levied for Volcker Rule noncompliance, and it was in response to a self-reported offense.[26] But the low penalty rate is almost certainly not the result of near-universal industry compliance. Several news reports over the past few years have detailed bank trades or fund investments that have resulted in large profits or losses, leaving the

public to wonder how the transactions were permitted under the Volcker Rule.[27] In 2016, for example, a Goldman Sachs trader made $100 million on junk bond trades that looked proprietary in nature, yet these transactions were not penalized under the Volcker Rule.[28] Recently, Deutsche Bank AG's U.S. arm reported a single-day trading loss 12 times larger than what the bank had calculated it could lose on a given trading day.[29] This trading loss, too, was not penalized—and perhaps not even analyzed—under the Volcker Rule. Given these and other outstanding questions related to bank compliance and regulatory enforcement of the Volcker Rule, greater transparency through the delayed release of relevant bank trading data would meaningfully strengthen Volcker Rule implementation.

Apart from increasing transparency, regulators could also strengthen the Volcker Rule by closing key loopholes and by enhancing its penalties.[30] The 2013 final rule includes several exclusions that have no basis in the statute yet weaken its reach and impact. For example, the 2013 rule carves out physical commodities from the Volcker Rule's prohibition against proprietary trading. As a result, banks have continued to speculate in physically settled commodities markets, despite the fact that the statute provides no such exemption. The congressional authors of the statute, Merkley and Levin, called on regulators to eliminate this exemption during the original rule-making process, but it made it into the 2013 final rule anyway.[31] Eliminating that loophole would simplify the rule and decrease the opportunities for banks to evade the Volcker Rule's intent. However, this is not the only regulatory loophole that has no statutory basis and ought to be closed. For example, as discussed below, another loophole involves trades executed for bona fide liquidity management purposes.

Regulators, however, did not include any of these improvements in the proposed rewrite. Instead, they offered changes that clearly serve the interests of banks over the public. For years, banks have asked for these changes. By delivering this rewrite, regulators are not sufficiently considering the well-being of the broader public, who bears the cost of reckless Wall Street activities.

This report discusses several ways the proposed rewrite of the Volcker Rule undermines the rule by providing more leeway for banks to engage in high-risk trading activities.

Allows banks to govern their own market-making and underwriting limits

The Volcker Rule was enacted, in part, to reorient banks toward client-focused activities.[32] Instead of making bets that swing for the fences and conflict with the interests of their customers, banks should serve their customers in a way that supports the real economy. The primary banking activity that accomplishes this goal is lending—providing credit to businesses, entrepreneurs, and households so that they can pursue economically useful ventures. Banks can also serve their clients through capital mar-

ket activities that perform the same effective function: enabling clients to succeed in their ventures. Banks' market-making activities enable clients to conveniently buy and sell financial instruments, while underwriting activities help clients to raise funds in the capital markets. Therefore, these two activities are permitted by the Volcker Rule.

The statutory language in Dodd-Frank made it clear that banks could not engage in these activities beyond the reasonably expected near-term demand (RENTD) of their clients.[33] This limitation was meant to stop banks from conducting proprietary trading under the guise of market-making or underwriting activities permitted by the Volcker Rule. For example, if a bank bought $10 million of certain corporate bonds and claimed the purchase was for market-making, and the expected near-term demand of the bank's clients was for only $3 million of those bonds, the bank could be making a $7 million proprietary bet that the bonds would increase in price. In this example, the bank would be taking a proprietary position by trading beyond the expected near-term demand of its clients. The 2013 final rule put in place some restrictions to prevent banks from engaging in that type of evasion, such as requiring them to perform specific analyses demonstrating the reasonably expected near-term demand of their clients. The required analyses had to consider historical demand for the financial instrument, the liquidity and maturity profiles of the asset, current inventory breakdowns, and other variables. Trades executed within the bounds of the expected near-term client demand are generally permitted for market-making and underwriting activities.

The proposed rewrite would drop the requirement for banks to perform the specified analyses demonstrating the reasonably expected near-term demand of their clients.[34] Instead, banks would be allowed to formulate their own internal risk limits using calculations based on variables that they themselves would select. As long as banks stayed within the bounds of their own self-designed risk limits, regulators would assume full compliance with the reasonably expected near-term demand restriction on market-making and underwriting activities. Banks would not need prior approval from regulators to set and adjust their internal risk limits; they would simply be required to notify regulators of the limits and any changes.

This proposed change would effectively let banks govern themselves when determining client demand. As a result, the SEC believes, "some entities may be able to maintain positions that are larger than RENTD and, thus, increase their risk-taking."[35] A bank could set internal risk limits that extend beyond the actual near-term demand of its clients, creating the space to engage in proprietary trading. In the run-up to the 2007–2008 financial crisis, this compliance approach failed spectacularly.[36] Banks were given the flexibility to determine their own loss-absorbing capital requirements using internal risk models; however, too many banks gamed their models to ensure they faced the weakest safeguards possible.[37] Putting faith in the banks to police themselves is not only misguided, it is contrary to the statutory requirements of the Dodd-Frank Act and the Volcker Rule.

Opens the door to another London Whale

Trades undertaken by a bank to hedge exposures—and therefore mitigate risk—are permitted under the Volcker Rule statute.[38] The Volcker Rule recognizes that it is prudent for banks to use financial instruments to reduce risks to their balance sheets. At the same time, the rule's statutory provisions did not intend to allow banks to take risky proprietary positions under the pretense that they were actually engaging in risk-mitigating hedging. By requiring banks to perform ongoing correlation analyses, the 2013 Volcker Rule regulation sought to limit the possibility of banks using the hedging exemption as a loophole to engage in prohibited trading.[39] Essentially, the regulation required banks to demonstrate, over time, that their hedges were actually reducing their risks. If, over time, the data showed instead that the value of an asset designated as a hedge was moving in the same direction as the value of the asset it was supposedly hedging, that asset would lose its status as a risk-reducing hedge. That type of commonsense correlation analysis offered a sensible, cost-effective means for proving that risk-mitigating hedges were, in fact, risk mitigating, while potentially exposing hidden proprietary trades.

The 2018 rewrite proposal would eliminate the requirement that banks perform the correlation analyses for their hedges. It contends that banks have found the analytical requirement to be a costly burden that could lead to delays in executing or adjusting hedges.[40] Putting aside the fact that workers, families, and investors all found it costly when the financial sector brought the U.S. economy to the brink of collapse, one has to wonder why any bank would decline to engage in the analysis needed to assure that its hedges are really reducing its risks. This is simply good risk management. Even if banks appropriately design a hedge at inception to reduce risk, it may not actually reduce risk over time. If the value of a hedge is moving in the same direction as the asset being hedged, and the bank is making more money on the trades as a result, a bank's profit incentive may govern the decision not to adjust the hedge. Without correlation analyses, this scenario is far more likely to occur.

Of equal concern is the proposal to remove regulatory language requiring banks to execute hedges that "demonstrably reduce or otherwise significantly mitigate" risk.[41] Removing that language raises serious concerns as to whether the revised rule would legally align with the statute, which permits hedging only to the extent that a hedge is risk-mitigating. Without having to demonstrate clearly that the hedge is actually a hedge—and that it significantly mitigates risk—it would be much easier for banks to engage in proprietary trading under the guise of hedging.

The 2013 regulation's concern about proprietary trading disguised as hedging is not merely theoretical. Before the 2013 Volcker Rule regulation was finalized, a massive $6 billion trading loss at JPMorgan Chase—known as the "London Whale" incident—was triggered by proprietary trading masked as hedging.[42] The trading operation that suffered the loss was supposedly trading credit derivatives in order to hedge risk broadly across the financial institution, as opposed to narrowly hedging specific

exposures.[43] The bank did document and track hedges designed to offset its interest rate and mortgage servicing risks but chose not to engage in the same analysis for the credit derivative trading activities.[44]

A Senate investigation into these trades uncovered significant evidence that the trades were indeed proprietary positions, not legitimate hedging activities.[45] During the original rule-making process for the Volcker Rule, some banks furiously lobbied for loose restrictions on hedging, seeking to ensure that the hedging exemption could serve as a backdoor way to engage in speculative activities.[46] They even succeeded in the original proposed rule in 2011. Portfolio hedging, a strategy through which a bank broadly hedges its risk without clearly documenting and tracking the specific exposures that are being hedged, was allowed in the proposed rule.[47] Yet, after the London Whale incident, advocates of a strong Volcker Rule were able to eliminate the portfolio hedging language, referred to by former Sen. Carl Levin as "a big enough loophole that a Mack truck could drive right through it."[48]

By eliminating the portfolio hedging language and including certain safeguards like the hedging correlation analyses, regulators sought to prevent banks from using the hedging exemption to evade the Volcker Rule's prohibition against proprietary trading. As former Treasury Secretary Jack Lew stated in 2013, "The rule prohibits risky trading bets like the 'London Whale' that are masked as risk-mitigating hedges."[49] It is tougher for banks to game the hedging exemption when they have to document the specific exposures and demonstrate that, over time, their hedges are actually reducing risk. The SEC's own analysis of the proposed rewrite stated that weakening the hedging requirements could allow some banks to engage in proprietary trading under the guise of hedging.[50] The agency observed that eliminating the correlation analysis requirement and lowering the bar for what qualifies as a hedge "may potentially increase moral hazard and conflicts of interest between banking entities and their customers."[51]

Expands the liquidity management loophole

The 2013 Volcker Rule regulation included a carveout for trades executed for bona fide liquidity management purposes. Liquidity management refers to actions taken by a bank to ensure it has the appropriate assets to meet its expected cash and collateral needs across the firm. Transactions that fall within this carveout are not restricted by the Volcker Rule's ban on proprietary trading. The carveout does not have any statutory basis in the Dodd-Frank Act and should be closed or restricted rather than maintained or expanded.[52] Its scope and potential for risk are likely to be worsened by changes in the proposed rewrite.

Specifically, the proposed rewrite seeks to expand the financial instruments that can be used under the liquidity management loophole to include foreign exchange (FX) swaps, cross-currency swaps, and forwards. An FX swap is a transaction in which counterparties simultaneously borrow one currency and lend another currency for a

set period of time. When the transaction is closed out, the counterparties then return the currency they borrowed and receive the currency they lent. The foreign exchange rate—both the spot price and forward rate—is included in the terms of the contract. Cross-currency swaps look similar to FX swaps but involve the exchange of interest payments throughout the term of the contract. These derivatives were not allowed under the liquidity management exclusion in the 2013 regulation. Banks can already use these instruments for permitted activities like market-making for clients or hedging exchange rate risk, but they must meet the corresponding compliance requirements to prevent abuses. To avail themselves of the liquidity management exclusion, banks must trade in accordance with their liquidity management plans. Generally, exclusions have a less robust compliance framework than permitted activities—like hedging or market-making—that fall within the bounds of the Volcker Rule.

Expanding the liquidity management loophole as proposed would be unwise, since FX swaps, cross-currency swaps, and forwards can easily be used to make large speculative bets in currency markets on the movements of exchange rates.[53] Banks could claim that they were trading these instruments under the liquidity management exclusion while actually taking proprietary positions in currency markets, potentially exposing them to the types of large and rapid trading losses that the Volcker Rule was meant to prevent. It is especially concerning that regulators would make it easier for banks to bet on exchange rates given that several Wall Street banks have collectively been fined billions of dollars for egregious exchange rate manipulation schemes spanning at least a decade.[54] In those schemes, banks colluded with one another to rig foreign exchange rates in order to increase their own profits.[55] Given this history of misconduct, regulators should be particularly cautious about making changes that give banks more of an opening to make high-risk bets in currency markets.

Like much of the proposed Volcker Rule rewrite, regulators do not offer any data or evidence justifying the proposed change. The proposed rule provides the public with no information showing that banks have struggled to manage their liquidity needs since the Volcker Rule came into effect in 2015. The SEC states that the proposed change "may also lead to currency derivatives exposures, including potentially very large exposures, being scoped out of the trading account definition and the ensuing substantive prohibitions of the 2013 final rule."[56] Moreover, the SEC also believes that banks may rely on this carveout to engage in currency market speculation.[57] If evidence exists that these instruments would solve a demonstrated problem with liquidity management, regulators should provide such evidence and use their authority under the Volcker Rule statute to convert the liquidity management exclusion into a new permitted activity with strong compliance requirements.[58] Unless regulators offer data-driven evidence that a serious problem exists, there is no rational basis for allowing banks to use these instruments under the liquidity management exclusion when they can be easily used for proprietary trading. The lack of data makes it impossible to evaluate the need for or impact of the proposed change, raising the possibility that it fails to meet the minimum requirements outlined by the Administrative Procedure Act.[59]

Eliminates foreign bank financing restriction

The U.S. operations of foreign banks fall under the scope of the Volcker Rule statute. As a general matter, foreign bank parent companies and other foreign bank subsidiaries—depending on the laws in their respective jurisdictions—are allowed to engage in proprietary trading and have unencumbered relationships with hedge funds and private equity funds. In accordance with the intent of the statute, however, the 2013 Volcker Rule regulation barred the U.S. operations of foreign banks from financing the prohibited activities of their foreign parents and other foreign affiliates. For example, Deutsche Bank's U.S. intermediate holding company is not permitted to lend money to its parent company in Germany for the purpose of acquiring a significant stake in a hedge fund. This prohibition mitigates the chance that the risks associated with proprietary trading or investments in hedge funds and private equity funds conducted abroad are imported to U.S. shores. During the 2007–2008 financial crisis, foreign banks—like U.S. banks—experienced severe losses on their trading activities, hedge fund, and private equity investments, and some were propped up with U.S. taxpayer funds.[60]

If the U.S. operations of a foreign bank were to lend to a foreign subsidiary of the bank and that loan were secured by a proprietary trading asset or by a covered fund investment, the value of the trade or fund investment could deteriorate and stress the balance sheet of the foreign entity. In this scenario, those losses would find their way to U.S. shores when the foreign subsidiary failed to pay back the loan. The U.S. operations of the foreign bank would write down the value of the loan, taking on the losses caused by the risky activities of the foreign parent or subsidiaries. If those activities were instead financed by another foreign subsidiary of the bank, the risk to the U.S. operations would be mitigated.

The Volcker Rule rewrite seeks to remove the financing restriction, allowing the U.S. operations of foreign banks to fund the otherwise prohibited activities of their foreign parent or other subsidiaries. There is no financial stability upside to this change. This will simply allow the U.S. operations of foreign banks to gain exposure to activities that are prohibited by the Volcker Rule. As the SEC found, "some of the economic exposure and risks of proprietary trading by foreign banking entities would flow not just to the foreign banking entities, but to U.S.-located entities financing the transactions."[61] The proposed rule offers no data, evidence, or reasoning to import additional risk to the U.S. financial system, again failing to meet the minimum requirements of the Administrative Procedure Act.

Weakens the definition of trading account

The Volcker Rule's prohibition on proprietary trading applies to all trading conducted for a firm's trading account.[62] Any transactions that occur outside of the trading account fall outside of the scope of the Volcker Rule, which makes the definition of

"trading account" crucial. The proposed changes to the rule would narrow this definition by likely placing fewer bank trading desks under active oversight by regulators.

The 2013 regulation uses three tests to determine whether trading is covered under the definition of trading account. The first test is known as the short-term intent or purpose test. This test covers any trading conducted with the intent to resell in the short term, to benefit from short-term price movements, to engage in short-term arbitrage, or to hedge a trading account position.[63] Accompanying this test is a 60-day rebuttable presumption, meaning, any position that is held for less than 60 days is assumed to be short term and covered. The second test is known as the market risk capital rule test. Under this test, any position that falls under the banking regulators' market risk capital rules is considered part of the trading account.[64] Finally, the third test—the dealer or status test—captures trades conducted by registered or licensed securities dealers, swaps dealers, or security-based swaps dealers when those trades are conducted in activities requiring the trading entity to be registered or licensed as a dealer.[65]

The Volcker Rule rewrite would keep the market risk capital rule test and the dealer test but eliminate the purpose test and the 60-day rebuttable presumption. The purpose test would be replaced by a new accounting test. Under the new test, trades that are recorded at fair value on a recurring basis—an accounting-related categorization—would be covered by the definition of trading account.[66] Trading desks that would be covered only by the new accounting test—not the dealer test or the market risk capital test—would benefit from a new presumption of compliance. As long as the trading desk does not exceed an absolute gain or loss of $25 million over a rolling 90-day period, regulators would presume that the desk is in compliance with the Volcker Rule. The bank would not have to demonstrate that its trading activity met a permitted activity like market-making or hedging as long as it stayed under that $25 million threshold.

This proposed change has no statutory basis and regulators do not provide a sufficient justification for how it meets the statute's requirements. The purpose test and 60-day rebuttable presumption stem directly from the statute's language, which explicitly states that the prohibition is meant to cover any trading that occurred for the purpose of benefiting from short-term price movements. Under the current rule, any trading—no matter the accounting treatment or where in the firm it is conducted—falls under the Volcker Rule if the position is held for less than 60 days. A better approach would have been to either increase the 60-day threshold to 90 days, or even a year—as the congressional authors of the Volcker Rule recommended during the original regulatory comment period—or to implement the accounting prong as an additional test without any presumption of compliance.[67] It should be noted that inclusion in the trading account is not a prohibition but rather the baseline requirement that triggers oversight under the Volcker Rule.

Again, under the Volcker Rule rewrite, a trading desk that is captured only by the new accounting test would not have to demonstrate compliance with the rule as long as the desk stays below a $25 million profit/loss threshold for a rolling 90-day period. As long as the desk stays below that threshold, it will not have to show that its trades are complying with the Volcker Rule. The proposed rule also points out that a potential opportunity for evading the rule stems from the accounting test's interaction with an additional change to the definition of "trading desk."[68] The proposal gives banks greater flexibility to define the business unit that constitutes a trading desk, potentially allowing them the flexibility to define their trading desks in such a way that minimizes the impact of the $25 million threshold and takes advantage of the presumption of compliance. Additionally, the $25 million figure appears to be an arbitrary selection. Much like the rest of the proposal, regulators provide no data or evidence to justify that number. Even more seriously, regulators do not have any statutory authority to create a de minimis exemption to the ban on proprietary trading. The statute created an explicit de minimis level of investment in covered funds that banking entities were permitted to make but created no such de minimis threshold for trading accounts. Creating such a regulatory exemption out of whole cloth is not permissible unless regulators provide relevant data, evidence, and analysis and make the necessary findings regarding the need to protect the safety and soundness of the banking entity as well as the financial stability of the United States. The proposed rule does not contain any of that information, analysis, or findings.[69]

Ultimately, the general principle that regulators should not pay attention to trading desks until something goes wrong is flawed. If regulators want to incorporate an accounting-related test, which has some benefits, they must eliminate any presumption of compliance.

Regulators had an opportunity to strengthen the definition of trading account. Instead, the new accounting test would limit the trading activity that falls under active oversight of regulators.[70] Removing more accounts from active oversight could lead to an increase in the proprietary trading that the Volcker Rule was precisely designed to stop.

Proposes other misguided changes

The proposed Volcker Rule revisions are extensive and make many additional changes to the 2013 regulation. The proposal creates three different sets of compliance requirements depending on the size of a bank's trading assets and liabilities. Banks with more than $10 billion in trading assets and liabilities are in the most stringent category, banks with between $1 billion and $10 billion are in the moderate category, and banks with less than $1 billion are in the limited category. While it makes sense that regulators should pay closer attention to a massive Wall Street bank than a regional or community bank, this fragmented compliance regime is not well-designed. Rostin Behnam, commissioner of the CFTC, dissented from the vote to propose the Volcker Rule rewrite

and referred to the tiering component as an "unnecessarily complex tapestry."[71] Given that the Volcker Rule rewrite has been put forward as a modest set of tweaks aimed to simplify the original rule, this is an especially pointed critique.[72]

Unlike the compliance regime established by the 2013 final regulation, the new compliance regime does not adequately factor in a bank's total consolidated assets; it merely focuses on the size of a bank's trading operation. This is a troublesome change because if high-risk trading activities were to lead to a bank's failure, the size of the entire institution would matter in terms of the risk posed to financial stability. For example, a trading meltdown at a $100 billion bank with $2 billion in trading assets and liabilities could pose a greater threat to the economy than a trading meltdown at a $40 billion bank with $2 billion in trading assets and liabilities. The corresponding compliance requirements should meaningfully factor in the total size of the institution, in addition to the size of its trading operation. However, the proposed Volcker Rule rewrite does not.

The proposal also creates a new exclusion for trades executed in error. If a trade is mistakenly executed, the bank can place that instrument into an error account managed by a separate trader. The trades conducted to correct the error would fall outside of the Volcker Rule's restriction on proprietary trading. Banking entities, of course, should be permitted to correct errors they make. But the proposal fails to explain or justify why an entirely new exclusion to the rule is needed. No data are offered to explain how prevalent or serious this problem is; how the existing regulation has contributed to the problem; or why other approaches are insufficient to resolve it. As such, it is nearly impossible to effectively comment on the problem being solved—or, possibly, created. Without sufficient oversight and restrictions, even error accounts could be used to evade the prohibition on proprietary trading. Banks could claim an error was made and profit on the short-term price movements of the instrument placed into the error account.

Beyond the potential for evasion, this change gets to the heart of the fallacy undergirding the Volcker Rule rewrite. Supporters claim the proposal is meant to simplify the Volcker Rule in response to complaints about the vague or complex nature of the 2013 regulation. But the new trading error exclusion would depend on "the facts and circumstances of the transactions."[73] Essentially, it is up to regulators to decide on a case-by-case basis what constitutes a trade made in error. That approach is vaguer than any aspect of the 2013 regulation. It does not simplify the rule; it merely injects it with more uncertainty. However, in this case, it is unlikely that banks will oppose this uncertainty, as it works in their favor.

Most of the proposed rule's changes deal with the proprietary trading half of the Volcker Rule. They do not significantly alter the covered funds definition, which determines which funds fall under the Volcker Rule's restrictions on hedge fund and private equity fund activities. However, the proposal contains at least 70 questions that solicit comments regarding possible changes to the definition of covered funds.

Many of the questions are specific, detailed, and leading. They hint at anything from the erosion to the evisceration of the covered funds definition, which would limit the number, types, and tranches of funds that fall under the Volcker Rule's prohibition. The covered funds section of the Volcker Rule proposal suggests that regulators intend to make dramatic changes to that aspect of the 2013 regulation—changes that, perhaps for the first time in a finalized rule, would short-circuit public analysis. Hopefully, regulators will not take that course of action and will instead respect the requirements of the Administrative Procedure Act and issue a second proposal open to public comment.

Most of the proposal's questions suffer from a lack of explanation, data, evidence, and justification regarding what is being done, why it is being done, what alternatives were considered, and what implications may exist. Any movement toward further action under most, if not all, of these questions would raise significant concerns under the Administrative Procedure Act.

These are not the only problems of a proposal that never should have seen the light of day; they are merely the most harmful.

Conclusion

The Volcker Rule is one of the key financial reforms that helped this country recover from the financial crisis and establish safeguards against future economic devastation caused by the financial industry. The rule's restrictions on highly risky trading activities make the banking sector safer, reorient banks toward traditional client-focused activities, and limit conflicts of interest with real investors in U.S. capital markets. The 2013 regulation could and should be improved. Unfortunately, the recently proposed rewrite does not make any meaningful improvements to the rule and would only serve to weaken it.

If regulators genuinely want to strengthen the Volcker Rule, they could implement a robust transparency regime, making bank compliance metrics public on a slightly delayed basis and publishing Volcker Rule enforcement data. This would give the public confidence in the rule, as academics, legislators, reporters, and other interested parties could monitor banks' trading activities and regulators' enforcement efforts.

Moreover, if regulators want a stronger Volcker Rule, they could eliminate loopholes. Bank trading of physical commodities and the previously outlined liquidity management exclusion are two such loopholes. Merchant banking activities, which resemble private equity investments and carry similar risks, could also be banned or restricted through regulatory action. Further restricting trading desk profits to commissions, fees, and spreads—as opposed to the price appreciation of assets in inventory—

would be another way to improve the rule. As SEC Commissioner Robert Jackson noted in his dissent to the proposed Volcker Rule rewrite, incorporating more stringent compensation restrictions for principal risk takers and executives—for example, finalizing strong Dodd-Frank Act Section 956 rules—is another option for beefing up the Volcker Rule.[74]

Unfortunately, regulators went in the opposite direction. The proposed changes serve banks, not the public. Despite having collected troves of data over the past three years during implementation and enforcement of the Volcker Rule, regulators fail to offer any data justifying the proposed changes. On 30 separate pages of the proposal, regulators cite their own experience, without any data-driven evidence to back it up. No rational basis is provided for the proposed changes. Bank profits are at all-time highs, market liquidity is within historical norms, and bank lending is healthy.

Before regulators invite more risk into the banking system, they should consider who bears the burden of such a decision. The former and final CEO of Lehman Brothers is doing fine; yet workers and families throughout the country still carry the scars of a decade ago.[75] Wall Street banks may find compliance with the Volcker Rule tedious, but families who lost homes found foreclosure catastrophic. Despite record profits, banks complain that the Volcker Rule is too costly and burdensome. But their desire for even greater profits should not concern regulators as much as the plight of Americans who lost their jobs, homes, and savings as a result of the financial crisis. Regulators should focus more on the potential severe costs of their actions to the real economy than minor inconveniences for bankers.

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Responses from Chairman Rodney E. Hood

Questions for the Record from Full Committee Hearing:
"Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions"
Thursday, May 16, 2019

Responses to Chairwoman Maxine Waters

Wells Fargo and Megabank Supervision, Enforcement and Accountability
6. *Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, please provide the Committee with a list of proposals that your agency has made, or is planning to make, that is responsive to recommendations by the Department of the Treasury in its series of regulatory reform reports and memoranda issued in 2017 and 2018.*

Response:
In June 2017, the Treasury Department issued a report titled, "A Financial System that Creates Economic Opportunities – Banks and Credit Unions." As outlined below, the report makes a number of recommendations for the NCUA. In 2017, the NCUA established a Regulatory Reform Task Force to oversee the implementation of the agency's regulatory reform agenda. The Task Force is consistent with the spirit of the President's regulatory reform agenda and Executive Order 13777. The Task Force published its final report on December 21, 2018.

Treasury Department Recommendation: Federal and state financial regulatory agencies should establish processes for coordinating regulatory tools and examinations across sub-sectors.

Action:
The NCUA shares supervisory oversight of federally insured, state-chartered credit unions (FISCUs) with state regulators. In general, examinations of FISCUs are almost always conducted jointly with state regulators. During a joint examination, the NCUA works closely with the state regulator to issue a joint examination report to ensure consistency and reduce or eliminate any overlap in efforts. The agency also has an NCUA-State Regulator Working Group that continues to explore ways to improve the shared supervisory oversight of FISCUs.

Treasury Department Recommendation: Easing the NCUA regulations relating to credit union capital and stress-testing requirements, including raising the scope of application for stress-testing requirements for credit unions to $50 billion from the current $10 billion.

Action:
In 2015, the NCUA adopted a final risk-based capital rule for federally insured, natural person credit unions that are considered "complex." In that 2015 rule, the NCUA defined a "complex credit union" as, in part, a credit union with assets greater than $100 million. In 2018, the NCUA further revised the definition of "complex credit union" to those with assets greater than

$500 million. In that same 2018 rule, the NCUA delayed the effective date of the risk-based capital rule for one year, to January 1, 2020.

At its June 2019 meeting, the NCUA Board issued a proposed rule to delay the effective date of the risk-based capital rule until January 1, 2022. During this delay, the NCUA plans to holistically evaluate the NCUA's capital standards for federally insured credit unions. In particular, two areas warrant additional consideration and potential action: authorizing "complex credit unions" to issue subordinated debt and count that outstanding debt for risk-based capital purposes, and updating the NCUA's capital requirements to reflect the risks associated with a credit union sponsoring a securitization of its assets. With regard to stress testing, in 2018, the agency issued a final rule, which, among other things, increased the threshold at which credit unions have to conduct stress testing to $15 billion.

Treasury Department Recommendation: Allowing appropriate supplemental capital to meet a portion of credit unions' risk-based capital requirements.

Action:
As noted above, the NCUA Board has issued a proposed rule to delay the effective date of the risk-based capital rule to January 1, 2022. During this delay, the agency plans to comprehensively evaluate additional improvements to credit union capital standards, including in the areas noted in the prior response.

Treasury Department Recommendation: Reviewing examination overlap and duplication. Recommends that the NCUA extend examination cycles for smaller credit unions in line with its recommendation that Congress raise the current asset threshold for smaller banks eligible for an 18-month examination cycle.

Action:
In 2016, the NCUA established the Exam Flexibility Initiative to evaluate the agency's examination and supervision program. That initiative has resulted in greater examination efficiency and flexibility for credit unions, while also improving the NCUA's coordination with state regulators. While not exactly comparable to the extended bank examination cycle, the NCUA has adjusted the frequency of examinations based on a credit union's size, complexity, operating condition, and, in the case of FISCUs, the frequency of state examinations. This approach has allowed the NCUA to focus more efforts on troubled credit unions, thereby addressing problems earlier when they are easier and less costly to resolve.

Treasury Department Recommendation: Recommends that the regulators conduct rigorous cost-benefit analyses and make greater use of notices of proposed rulemakings to solicit public comment, at least with respect to all "economically significant" proposed regulations.

Action:
Executive Order 12866 requires federal agencies, when deciding whether and how to regulate, to assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. It counsels covered agencies, when choosing among alternative regulatory approaches, to select those that maximize net benefits (such as potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity),

unless a statute requires another regulatory approach. While Executive Order 12866 expressly does not apply to independent regulatory agencies, the NCUA complies with its spirit by assessing the economic impact of our proposed regulatory actions. The agency makes great use of the notice and comment rulemaking process, not just in the context of regulations that may be defined as "economically significant," giving all interested stakeholders an opportunity to provide input and inform our rulemakings. In addition, wherever possible, we provide targeted relief by issuing regulatory exemptions and adopting tailored regulations that are scaled to a credit union's asset size, scope, and complexity. This tiered approach to regulating credit unions helps ensure that smaller entities are not unnecessarily burdened by mandates that are more appropriate for larger institutions.

Treasury Department Recommendations:

1. Recommends an interagency reassessment of the volume and nature of matters requiring attention (MRAs), matters requiring immediate attention (MRIAs), and consent orders to evaluate impact, consistency and overlap, and to establish consistent interagency standards.

2. Recommends that regulators and banking organizations develop an improved approach to addressing and clearing regulatory actions.

Action:
The NCUA policy limits what examiners may include in a Document of Resolution (known as a DOR at the NCUA, but as an MRA at the other federal financial banking regulators). A DOR may include only those issues significant enough to warrant escalation to the next level of enforcement if the related credit union fails to correct the problem. These types of issues are unsafe or unsound practices that reasonably threaten the stability of the credit union, or they are violations of law or regulation that are systemic, recurring, or result from willful neglect. The NCUA routinely analyzes the volume and nature of DOR items to ensure that examination staff are identifying problems and issuing corrective actions in accordance with agency policy.
The NCUA's National Supervision Policy Manual generally requires examiners to follow up within 120 days after the date by which the credit union must remedy the issue underlying the DOR. This allows the NCUA to ensure that such issues are addressed and cleared or, if warranted, to escalate enforcement action against the credit union. With respect to FISCUs, the NCUA and state regulators coordinate efforts to clear or escalate administrative actions, as appropriate.

Fintech
There has been tremendous interest in financial technology, or fintech, and the Committee has formed two task forces to more closely examine fintech and AI.
14. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles: GAO issued a recent report making a series of recommendations that the regulators coordinate better on fintech issues. Please outline what specific steps is your agency taking to respond to these recommendations, and coordinate better with other regulators?

Response:
The NCUA has implemented two of the recommendations provided by GAO and is taking steps to implement the remaining two. Specifically, the agency is in the process of creating an Office of Innovation and Access that will provide dedicated resources and a clear point of contact for fintech and innovation-related issues. Once established, this office will identify and implement additional knowledge-building initiatives related to financial innovation.

In addition, the NCUA continues to actively coordinate on fintech issues with the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Consumer Financial Protection Bureau. Agency representatives will continue to participate on interagency working groups and discussion forums to identify and participate in opportunities for coordination.

15. Chairman Hood, what is your view of the rapid growth of financial technology, or fintech, in the financial services marketplace? How will the work of credit unions be affected? What are your top priorities at the NCUA with respect to fintech?

Response:
The confluence of mobile communication device access, cutting-edge technology, and the ease of entrance for new market participants is revolutionizing the financial services industry. This provides a great opportunity for credit unions and other financial institutions to improve product and service delivery, enhance operating efficiency, and expand services to benefit traditionally underserved and low-income communities. However, fintech also represents a new potential source of disruption for traditional depository financial institutions.

The NCUA's goal is to maintain the safety and soundness of credit unions without stifling their use of innovative technology and related vendors. Credit unions need to embrace new and innovative ways to deliver financial services, while simultaneously understanding and managing the risks involved. One of my top priorities is to dedicate agency resources to establish a formal office, as discussed in response to question 14, to centralize research, outreach, and communication efforts for fintech and innovation related initiatives. The NCUA will continue to stay abreast of related developments and any implications for the agency's regulatory and supervisory frameworks.

Credit Unions
As of December 2018, there were 5,375 federally insured credit unions with a combined $1.45 trillion in assets and $1.2 trillion in deposits. Credit unions added 4.9 million members over the year, with a total credit union membership of 116.2 million by the end of 2018. Credit union lending increased overall by 9 percent last year. There have been a number of regulatory proposals and reforms NCUA has advanced in recent years, including extending the examination cycle for well-capitalized and well-managed credit unions, modernizing NCUA's field of membership rules, and modifications to centralize NCUA's appeal process for credit unions. In addition, in October 2018, NCUA amended its 2015 risk-based capital rule to delay the effective date until 2020, and raise the asset threshold from $100 million to $500 million in assets.
26. Chairman Hood, what are your top priorities at the NCUA?

Response:
My paramount responsibility is to protect the safety and soundness of the credit union system – both the credit unions themselves and the National Credit Union Share Insurance Fund (Share Insurance Fund). I have articulated several priorities that are important to the credit union system and necessary for ensuring that the U.S. financial system gives everyone an opportunity to access mainstream financial products. As I noted in my testimony before the House Financial Services Committee in May, cybersecurity is an ever present issue. Cybersecurity threats and other technology-related issues continue to be of key interest and concern to the NCUA. Cyberattacks pose an acute threat to credit unions, financial regulators, and the broader financial system. Cyber threats such as phishing scams, ransomware, and malware have proliferated in recent years, and financial institutions like credit unions are prime targets. That is why the NCUA again made cybersecurity assessment one of its primary areas of supervisory focus in 2018, and why I will continue to prioritize it. To that end, I recently appointed a cybersecurity advisor who provides me with strategic counsel on cybersecurity policy and engages with other federal financial regulators and external stakeholders.

With regard to increasing access to affordable and stable financial services, as I elaborated on in my written testimony before the Committee, I am committed to promoting financial inclusion and shared prosperity in underserved communities and fostering an environment where those with low-to-moderate incomes, people with disabilities, and the otherwise underserved have access to affordable financial services.

One specific way in which the NCUA is focused on inclusivity is our effort to help credit unions reconsider job applicants with relatively minor past criminal records. As the NCUA's Chairman, my primary job is to protect the safety and soundness of the credit union system. But where appropriate, I also want to encourage the entire financial services industry to take reform-minded steps to better meet the needs of the communities in which they serve. I am proud that one of my first actions as Chairman was to approve a waiver for an individual who wanted a job at a credit union, but was stymied by her past as a drug addict with a criminal record that included larceny and theft. She was a younger woman at the time of her conviction.

At a broader level, the NCUA has now unanimously proposed guidance we provide to credit unions when they consider a job applicant with a checkered past to see if we can make changes. A great many are not violent or career criminals, but rather people who made a mistake early in life who have since paid their debt to society. These individuals could be a significant potential economic resource, yet they face hiring barriers that leave them unemployed or underemployed. The value of lost output of people with criminal records who have difficulty finding employment has been estimated at between $78 billion and $87 billion. Those numbers represent a significant drain on our economy. Opening a path forward for more of these people will reduce recidivism and poverty while strengthening families and communities.

Overall, educating consumers, creating a regulatory environment that is effective but not excessive, and improving the chartering process for new credit unions are all important ways in which I believe we can increase access.

27. Chairman Hood, as we saw in the financial crisis 10 years ago, credit unions can run into safety and soundness problems. With respect to the risk-based capital rule, do you believe that rule will help mitigate some of the problems large credit unions could face in a future crisis or downturn?

Response:
The NCUA's primary mission is to protect the safety and soundness of the credit union system and the Share Insurance Fund. Since the financial crisis, the NCUA has undertaken a variety of initiatives consistent with the lessons learned from the crisis, designed to strengthen the agency's ability to identify and mitigate risk in the system. As I stated in my testimony before the Committee, the credit union system's aggregate net worth ratio stands at a robust 11.30 percent, well above the seven percent statutory level to be considered a well-capitalized credit union.

The risk-based capital rule is just one element that the NCUA continues to evaluate in our approach to risk mitigation. My philosophy has always been that regulation needs to be effective, but not excessive. This maxim applies equally to capital requirements at financial institutions. Overly restrictive, "one size fits all" capital requirements can inhibit lending without having an appreciable impact on the safety and soundness of a given bank or credit union. This is but one of the reasons I advocated a delay in the effective date of the risk-based capital rule, as described above in response to question six. The proposed delay provides an opportunity for the NCUA to holistically evaluate capital standards for federally insured credit unions.

While effective capital requirements are very important, risk-based capital standards are not a panacea for safety and soundness. Risk-based capital is designed to address a distinct range of credit risk outcomes, but not to prevent credit related financial institution failures caused by very severe economic scenarios. Further, capital standards are intended to work in tandem with a multi-faceted array of risk mitigation requirements. These include standards for liquidity, credit administration, governance, risk management, and so on – all reinforced by a robust examination and supervision program and various agency enforcement authorities. With all that in mind, and a healthy economy, high credit union net worth at over 11 percent, very low levels of problem institutions, and a strong Share Insurance Fund, the NCUA can certainly take additional time to carefully evaluate and make improvements to our capital standards without creating undue risk to the Share Insurance Fund.

As I learned during my first tenure as an NCUA Board Member from 2005-2009, risk cannot be altogether avoided. That is why, during that time, I launched a series of Enterprise Risk Management Summits that provided training sessions to credit unions on how to mitigate and manage risk. Working in collaboration with regulators from the Federal Reserve, OCC, FDIC, Federal Home Loan Banks and the National Economic Council, I hosted sessions with subject matter experts and credit union leaders that addressed risk areas such as liquidity, interest rate, and concentration. In my return to the NCUA as Chairman, I plan to restart those summits, focusing on some of those same risks, such as liquidity and concentration risk, and adding new ones, such as cybersecurity.

Payday Loans and Small Dollar Credit
Some of the biggest concerns regarding payday loans and the small dollar credit industry are that consumers end up in "debt traps" whereby consumers are borrowing one loan to pay off another. On April 30th, our Consumer Protection and Financial Institutions Subcommittee held a hearing entitled "Ending Debt Traps in the Payday and Small Dollar Credit Industry." Rev. Dr. Haynes from the Friendship West Baptist Church in Dallas, TX, testified about one his congregants, stating, "One of my members, a 74-year-old senior citizen, who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer. Now she feels like the devil answered her prayer. She is on a fixed income and when the repayment was due, she didn't have enough and had to take out another loan to pay the first one. She ended up with a dozen loans. When she approached me for help one Sunday after church, this once proud senior saint with good credit, was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620%! She was "dealt a bad hand with a bad plan." She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse."
28. Chairman Hood, what are your views on small dollar lending provided by credit unions compared to payday lenders? How does the NCUA ensure what the credit unions offer is sustainable and does not put consumers into a debt cycle?

Response:
Credit unions offer safer alternatives to traditional payday loans that provide consumers with a real pathway towards mainstream financial services. Since their creation at the turn of the 20th century, America's credit unions have provided people of modest means with access to affordable credit for provident and productive purposes. It is part of the mission of the credit union movement to expand economic opportunity, to help people from working and middle-class backgrounds to access capital, and to provide quality credit and saving services to those in need.

Today, one of the many ways that credit unions fulfill this mission is through offering payday alternative (PALs) loans. 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 PALs 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, over 80 percent of federal credit unions offering PALs loans report payments to credit bureaus – a critical step towards borrowers building access to mainstream financial services and breaking the cycle of debt. Overall, the products that credit unions provide are safer and much more consumer-friendly than traditional payday loans.

31. Comptroller Otting, Chairman McWilliams, Chairman Hood, and Vice Chairman Quarles, what kinds of measures can you as regulators put in place to ensure that banks aren't charging interest rates above 36%?

Response:
Federal credit unions do not charge interest rates above 36 percent. The Federal Credit Union Act caps the interest rate on federal credit union loans at 15 percent, with agency discretion to raise that limit if interest rate levels could threaten the safety and soundness of credit unions. The current 18 percent ceiling has remained in place since May 1987. The 18 percent cap applies to all federal credit union lending, except originations made under the NCUA's consumer-friendly PALs program, which are capped at 28 percent, far lower than the triple-digit interest rates charged by payday loan purveyors, as noted in response to question 28 above.

Diversity and Inclusion – NCUA
In NCUA's 2018 OMWI report, the agency sponsored leadership development programs that provide employees with training and growth opportunities. However, only 31% of those participants were minorities and the rest were white.
40. Chairman Hood, considering that minorities comprise only 18.9% of your senior staff, what will you do to make sure more minorities participate in programs that prepare them for leadership opportunities?

Response:
The NCUA is committed to ensuring that all employees have fair and equal access to development programs and opportunities. We strive to ensure we have a diverse slate of candidates for leadership development programs and for vacancies in our senior staff. We do not, however, select candidates based on race or any other protected class.

Although minorities make up 18.9 percent of our leadership team, 29.7 percent of our leadership development program participants are minorities. As such, the higher the percentage of minorities that participate in our leadership development programs, the larger the minority pipeline is for leadership positions. I believe expanding diversity in leadership starts with recruiting from a diverse applicant pool, which is why I have directed the NCUA to focus on conducting job fairs and other outreach to historically black colleges and universities, for example. To encourage more minority participation in leadership, we also have a formal mentoring program to prepare all employees, including minority employees, for leadership.

41. Chairman Hood, when will this guidance be available to credit unions, who at NCUA is preparing it, and when can it be provided to this committee for review?

Response:
The NCUA's Office of Minority and Women Inclusion (OMWI) is responsible for creating guidance to assist credit unions with diversity and inclusion efforts. OMWI uses the results of the voluntary Credit Union Diversity Self-Assessment to determine what areas receive the lowest scores. For the past two years, the results have consistently shown that reporting credit unions do not have successful practices in place to ensure diversity within their business activities. In September 2018, OMWI published the Credit Union Guide to Supplier Diversity to give credit unions a foundation for supplier diversity efforts and explain how and why to build a supplier diversity program.

Earlier this year, OMWI identified credit union board member diversity as an area in which the NCUA can help credit unions expand their efforts in diversity and inclusion. In the fourth quarter of 2019, OMWI expects to complete and distribute to credit unions a guide similar to the Credit Union Guide to Supplier Diversity. We will certainly be happy to provide copies of this guidance to the Committee.

42. Chairman Hood, rather than simply considering convening diversity professionals, how quickly can your agency implement this as a directive and an imperative exercise so that NCUA better understands the specific diversity and inclusion needs of the credit union industry?

Response:
The NCUA does not have the regulatory authority to make such a convening mandatory, but we are working with credit union leaders to determine what would be most interesting and helpful to them to further encourage their participation.

Diversity and Inclusion – Full Panel
In June 2015, your agencies along with the SEC and the CFPB adopted the Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies. Despite urging from many Democrats that those standards for diversity assessments be mandatory and publicly disclosed by regulated entities, the final standards were voluntary, leaving an opportunity for continued opaqueness about industry diversity and inclusion. Under the voluntary standards, our review of your most recent OMWI reports reveals that each of your agencies have low participation by your regulated entities in completing the requested diversity and inclusion self-assessment. For example, among your respective regulated depository institutions, only 16% reported to FDIC; 9.3% reported to OCC; 6.0% reported to the Fed; and a mere 1.5% reported to NCUA the results of their diversity self-assessments.
43. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, what plans have you discussed with your OMWI directors and your regulated entities about how to increase participation in providing diversity self-assessments?

Response:
Within the NCUA, I have discussed the need to more proactively message the business case for diversity and inclusion for credit union growth. We have discussed the same with credit union leaders, as well as ways the NCUA can foster trust that the data will not be used punitively. Finally, the agency has shared best practices that have resulted in positive business outcomes for credit unions.

44. For the diversity data that has been shared, what type of analysis and advice, if any has been shared about regulated entities' diversity and inclusion efforts?

Response:

The NCUA issued an analysis of the 2017 submissions in 2018. The NCUA issued an analysis of the 2018 submissions earlier this year.

45. What type of guidance has been provided to bank examiners on how to evaluate diversity and inclusion practices at regulated entities?

Response:
The NCUA does not have the statutory authority to examine for diversity and inclusion. Credit union examiners, therefore, do not evaluate diversity and inclusion practices during the examination process.

46. At your agencies, who do OMWI directors report to and to what extent are OMWI directors and other leadership at your agencies, including you, accountable for diversity results?

Response:
The NCUA's OMWI director reports directly to me. Senior leaders and supervisors have specific performance standards related to diversity and inclusion, such as creating an inclusive work environment and supporting the agency's equal employment opportunity initiatives. These are included in managers' performance plans.

Incentive-Based Compensation
The Wells Fargo fraudulent account scandal, and its incentive-based cross-selling strategy that fueled it, is a stark reminder how important it is for financial regulators to finalize executive compensation rules. As you know, Section 956 of the Dodd-Frank Act directed the regulators to adopt joint rules aimed at prohibiting incentive compensation arrangements that could encourage inappropriate risks at financial institutions. The regulators made an initial proposal in 2011, then reworked the proposal and issued a new plan in 2016. The proposal increases in stringency based on the financial company's asset size with enhanced requirements for senior executive officers and significant risk-takers.

47. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, there was much discussion at the hearing regarding the fast implementation of S. 2155 enacted by the 115th Congress. However, there are a few much older mandates that your agencies have not yet finalized. For example, given that Section 956 of the Dodd-Frank Act regarding incentive-based compensation is not a discretionary requirement, but a mandatory one, what steps are each of your agencies taking to prioritize the rule's implementation and enforcement of this provision of the law?

Response:
I assure you that the agency will do its level best to help the interagency group move forward as expeditiously as possible.

48. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, please provide the Committee with a timeline for each specific mandate required by S.

2155 from the 115th Congress and the Dodd-Frank Wall Street Reform and Consumer Protection Act that requires a rulemaking that your agency has yet to be finalized.

Response:
The NCUA has completed all of the S.2155 requirements and, with the exception of Section 956 noted above, has completed all of the Dodd-Frank Act requirements.

Bank Secrecy Act/Anti-Money Laundering (BSA/AML)
As regulators, you have indicated that relieving the burdens on banks, especially those placed on banks through the Bank Secrecy Act is a highest priority. While compliance is expensive, the trade off in lowering BSA compliance standards is potentially weakening safeguards to combat terrorists and criminal activity where their financing flows through the U.S. financial system.

50. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, banks and credit unions often complain they do not receive meaningful feedback on whether their efforts on BSA/AML are helpful to law enforcement. What steps is your agency taking to provide better feedback and guidance to community banks and credit unions? What steps is your agency taking to ensure law enforcement has all the information it needs to combat terrorism and illicit activity?

Response:
I am very committed to strong safeguards against money laundering, terrorist financing, and other criminal activity. The NCUA closely coordinates with law enforcement, FinCEN, and the other federal financial banking regulators regarding compliance with Bank Secrecy Act and anti-money laundering (BSA/AML) requirements. We also carefully examine federally insured credit unions regarding the same. However, I do believe there are ways to update and improve BSA/AML requirements to reduce the burden on financial institutions and maintain, and even improve, their effectiveness. For example, various innovations are occurring in approaches to identifying and reporting suspicious activities that could make this activity more efficient and effective for credit unions. I believe strongly that our regulatory and supervisory requirements need to keep pace with these innovations.

With respect to feedback, I, too, have heard credit unions express concern about not receiving feedback on the results of their BSA/AML efforts. While we cannot share confidential, law enforcement, sensitive, or national security-related information, we can do more to help increase awareness about how the collective efforts of credit unions are very useful to law enforcement and are helping to keep America safe. The NCUA is working with our peer regulators, FinCEN, and the Treasury Department to raise awareness in this regard. In fact, the NCUA periodically invites law enforcement to speak with examiners and credit unions to help them better understand the importance of their BSA/AML efforts.

Financial Stability and Lessons from the Financial Crisis
51. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, earlier this week, former Fed Chairs Bernanke and Yellen, along with former Treasury Secretaries Geithner and Lew, wrote a letter to Chairman Powell and Secretary Mnuchin about

a proposal by FSOC to make it much harder to designate a future AIG that poses a systemic risk to the financial system. The former officials wrote, "Though framed as procedural changes, these amendments amount to a substantial weakening of the post-crisis reforms. These changes would make it impossible to prevent the buildup of risk in financial institutions whose failure would threaten the stability of the system as a whole." Given these significant concerns, will FSOC reconsider its proposed guidance that would, in the words of these officials, "neuter the designation authority"?

Response:
In early March, FSOC issued new proposed interpretive guidance for how it would designate a nonbank financial company for enhanced supervision and prudential standards. One of the hallmarks of this guidance is for FSOC to use an activities-based approach for identifying and addressing risks to U.S. financial stability. The guidance was approved unanimously by all of FSOC's principal members, including my immediate predecessor as the NCUA Chairman. Over the following 60 days, FSOC received many public comment letters, the majority of which were generally supportive of the guidance. As you note, however, there were some comments that were critical of the proposal and which offered suggestions for ways in which it might be improved. In the coming months, FSOC will be working diligently to review these comments and, if needed, to incorporate any improvements to the proposal. The goal is to produce final guidance that offers the most robust tools and processes for addressing potential systemic risks to the U.S. financial system in an efficient and transparent manner.

52. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, given that FSOC is taking a so-called "activities-based approach" to supervising for systemic risk, is that any different than the weak financial stability oversight we had before the financial crisis, especially since FSOC has no authority to mandate new regulations to address systemic concerns identified through an activities-based approach?

Response:
According to the proposed guidance, FSOC will identify risks to U.S. financial stability on an activities or product-based approach. When it identifies such risks, it will work with the primary financial regulatory agencies to address them. If the primary regulators do not take sufficient action to address risks, FSOC retains its unique authority to designate a specific nonbank company or companies for enhanced supervision and prudential standards. That authority does not disappear with the proposed activities-based approach. FSOC maintains an explicit responsibility to oversee the entire financial system and to address systemic risks.

53. Chairman Hood, as you know, the credit union system was not immune from its share of problems in the financial crisis a decade ago. From 2008 through June 2011, 5 corporate credit unions failed, which held 75 percent of all corporate assets in the credit union system at the time. They suffered $30 billion worth of losses, about a third of the approximately $90 billion in combined capital all credit unions maintained then. With that in mind, do you think lessons from the financial crisis have faded in the minds of some policymakers? What is your diagnosis for the causes of the financial crisis, and what lessons did you learn from the crisis that you are applying to your work as Chairman?

Response:
Speaking personally, the lessons from the financial crisis certainly have not faded at all in my mind. I was an NCUA Board Member during the crisis. I saw firsthand how the crisis shook the foundation of the entire U.S. financial system and devastated the lives of millions of Americans. Retail credit unions were not at the source of the financial crisis, particularly in terms of the quality of the loans that they made at that time, but they were negatively impacted by the crisis.

In terms of the causes of the financial crisis, I believe that there were gross failures in key parts of the financial services industry. Bank underwriting standards, particularly for subprime mortgages, deteriorated sharply in the years leading up to the crisis. The securitization of these risky mortgages in ever more exotic ways proliferated, abetted by faulty credit rating practices that failed to properly recognize the inherent risks of these securities. Meanwhile, some sources of liquidity proved to be fragile and risk management practices at individual financial institutions were often flawed. As you note, corporate credit unions were not immune from many of these problems. As a result, the NCUA made significant changes to the rules governing corporate credit unions, including imposing prohibitions on investments that contributed to corporate losses, requiring enhanced corporate governing practices, and establishing concentration limits for investments and credit risk. An independent third party validated our standards and confirmed their effectiveness. In addition, the NCUA's Office of National Examination and Supervision monitors the financial health of corporate credit unions on a monthly basis and has also improved its oversight of corporate investments since 2008. Today, all corporate credit unions have greatly enhanced their capital buffers and are in compliance with the new investment restrictions.

The NCUA is ever mindful of the many lessons that the crisis taught us. I believe that regulators need to be vigilant, proactive, and at the forefront of emerging trends in the financial industry that may not have existed even just a few years ago. Cybersecurity threats and other technology-related issues, for instance, are of key interest and concern to me in part because the next crisis may well contain a cyber-component. As I noted in my testimony before the Committee in May, these issues keep me up at night. I also believe that enterprise risk management, particularly in the areas of liquidity and concentration risk, is vital for financial institutions of all sizes and must continue to be a focal point in the supervision and examination process. Additionally, financial regulators must coordinate to reduce regulatory blind spots and work together. While no one is clairvoyant, it is possible that future financial crises will present different risks and challenges than the ones we have confronted in the past. We must remain vigilant about not repeating the mistakes of the past, but also forward looking in anticipating present and future risks.

54. Chairman McWilliams and Chairman Hood, do you believe there are any financial regulations that need to be strengthened, or areas that Dodd-Frank did not go far enough?

Response:

Since the last financial crisis, Congress and the financial banking regulators have taken a variety of actions to strengthen the oversight of the U.S. financial system and reduce the regulatory gaps that contributed to the financial crisis. These steps have led to a more resilient financial system overall and more rigorous risk management at financial institutions, both large and small.

55. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, has the Financial Stability Oversight Council (FSOC) helped to eliminate regulatory gaps in our financial regulatory system? Should Congress consider legislation to strengthen FSOC's tools to ensure it is well equipped to head off a future crisis?

Response:
The FSOC principals meet regularly to discharge our statutory duties and our staff meet even more frequently through the various FSOC subcommittees and working groups to share information, discuss possible emerging threats to financial stability and, when necessary, coordinate on potential policy actions (rulemaking, reporting, enforcement, etc.).

To the extent Congress is considering additional legislation, I would be happy to discuss this issue with you further.

Responses to Congressman Bill Posey

For Chairman Hood: I hear from credit unions that they are worried about the combined impact that the pending implementation of the National Credit Union Administration's Risk-Based Capital Rule and the Financial Accounting Standards Board's new standard will have on them and their ability to provide loans to members. Among the regulatory relief accomplishments cited in your testimony, you list delaying the effective date of the NCUA's risk-based capital rule, and decreasing the number of credit unions covered by the rule. In the last Congress, I introduced legislation which was marked up by this Committee, and subsequently passed the House floor three times, to accomplish the same delay to permit NCUA to reconsider the rule and moderate its impact on credit unions. Do you plan to revise the Risk-Based Capital Rule, and if so, when can we expect a notice of proposed rulemaking?

Response:
At its June 2019 meeting, at my direction, the NCUA Board considered a rule to delay the effective date of the risk-based capital rule to January 1, 2022.

During this delay, the NCUA plans to holistically evaluate the agency's capital standards for federally insured credit unions. In particular, the following two areas warrant additional consideration and potential action:

- The first area is a regulation authorizing a "complex credit union" to issue subordinated debt and count that outstanding debt for risk-based capital purposes, as well as making related improvements to the standards for subordinated debt instruments that qualify as secondary capital for low-income designated credit unions.

- The second area is an update to the NCUA's capital requirements to reflect the risks associated with a credit union sponsoring a securitization of its assets. Asset securitization can be a useful tool for credit unions and other depository institutions in managing their balance sheets. It is complex activity, however, with associated forms of risk, including credit risk. This authority was recently identified as available to credit unions, so, accordingly, the NCUA's prudential requirements, including capital standards, need to be updated.

Follow up question*: Can you please tell us what criteria you applied in reducing the number of credit unions covered by the rule?*

Response:
Under the Federal Credit Union Act, the prompt corrective action standards for federally insured credit unions must include "a risk-based net worth requirement for insured credit unions that are complex based on the portfolios of assets and liabilities of credit unions."[1] In 2015, the NCUA adopted a final risk-based capital rule that defined a "complex credit union" as a credit union with assets greater than $100 million. In 2018, the NCUA further revised the definition of

[1] §1790d(d)

"complex credit union" to those with assets greater than $500 million. This revision exempted an additional 1,026 credit unions from the reach of the 2015 rule. Following this change, the NCUA's risk-based capital rule exempts approximately 90 percent of all federally insured credit unions, but still covers over 75 percent of total credit union system assets.

The NCUA bases its complex credit union definition on an analysis of products and services credit unions are engaged in that are complex. The revised definition also better takes into account the prevalence of multiple complex activities and volume of the complex activity engaged in by federally insured credit unions.

For all the panelists: *Some economists believe the emphasis on capital requirements conditioned on perceptions from the financial crisis have unduly restricted capital market expansion and really don't provide a great deal of protection against a liquidity-driven downward spiral in asset prices. Capital — even if insufficient — didn't really go very far in the crisis. The commercial banking system works because we have a clearing system of short-term credit to meet liquidity constraints by banks borrowing overnight when they are short and lending when they are long. Do we need to think about policies or measures to better assure the ability of securities dealers and investment bankers to rollover their credit and keep the asset markets stable and avoid the kinds of liquidity instabilities we saw in the crisis?*

Response:
Certainly, the tumult in liquidity funding markets, particularly for short-term credit, was a key factor in exacerbating the financial crisis. Since then, there has been much regulatory action aimed at bolstering liquidity risk management throughout the financial system.

Since 2010, the NCUA has issued guidance, expanded regulations, and increased supervisory focus to address liquidity risk. Specifically, in March 2010, the NCUA, in conjunction with the other FFIEC agencies and the Conference of State Bank Supervisors, adopted the FFIEC Interagency Policy Statement on Funding and Liquidity Risk Management. The policy statement summarized the principles of sound liquidity risk management that the agencies have issued in the past and emphasized supervisory expectations for all depository institutions including credit unions.

The NCUA continues to monitor and emphasize the importance of sound liquidity risk management. In October 2013, the NCUA board issued a final regulation that requires all federally insured credit unions to maintain a basic written liquidity policy. Depending on a credit union's asset size, a contingency funding plan and/or access to a backup federal liquidity source for emergency situations is also required. In March 2014, the agency issued a supervisory letter which provided additional information about a revised liquidity review questionnaire we developed to establish a consistent examination and supervision framework to review liquidity risk management at credit unions.

Finally, the NCUA identified liquidity risk as a supervisory priority for 2019.

For all the panelists: *Are current bank capital requirements based on Basel and other research really providing risk reduction benefits that exceed their prospective costs in terms of restricting credit and capital markets?*

Response:
The NCUA's core mission is to protect the safety and soundness of the credit union system, including the National Credit Union Share Insurance Fund (Share Insurance Fund). The Federal Credit Union Act requires the NCUA to maintain a system of prompt corrective action for federally insured credit unions that is based on an institution's level of capital – i.e. it's net worth. I strongly support maintaining capital standards that are effective and appropriately calibrated to the risks in credit unions. A healthy and vibrant credit union system is one that has strong capital, liquidity, and management at its core. We recognize that credit unions must take well-managed and measured risks to achieve their member service mission. With the broad diversity in credit union membership, lending approaches, and business strategies comes a broad range of risk profiles. It is, therefore, important that capital standards for credit unions account for this diversity in risk.

However, I also note that, while very important, risk-based capital standards are just one element in risk mitigation. They are designed to address a distinct range of credit risk outcomes, but not to prevent credit-related financial institution failures caused by very severe economic scenarios. In evaluating a credit union's safety and soundness, the NCUA employs a broad array of risk mitigation requirements, including, standards for liquidity, credit administration, governance, and risk management – all reinforced by a robust examination and supervision program and various agency enforcement authorities.

For all the panelists: *Legislation under consideration in this hearing would expand oversight by making additional hearings mandatory for the prudential regulators. Shouldn't we hold these hearings when events prompt them rather than blindly require them at recurring intervals? Can we rely on a process of written reports with appropriate issues focus from you and our own surveillance of the financial system to alert us to the need for oversight hearings? Do you have any specific ideas in this regard?*

Response:
I believe the hearing process is a matter for Congress to determine. However, I note that the NCUA regularly compiles data on the credit union system's financial performance, merger activity, and broader economic trends that can affect the safety and soundness of federally insured credit unions. In addition, we publically release detailed information on our budget, spending, performance results, and financial management. The NCUA's examination program focuses on the greatest risks to the credit union system and the Share Insurance Fund. Our rulemaking initiatives, executed through the public notice and comment process, respond to changes in the financial services sector and address emerging risks. All of this information, including legal opinions, rulemakings, call report data, and financial performance reports, is available to the public on the website at www.ncua.gov.

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Responses to Representative Ben McAdams

To all witnesses:

During the hearing, most witnesses testified regarding the risk cyber threats and attacks could pose to the financial system broadly, and individual financial institutions specifically.

1(a) Will you please explain the extent prudential regulators coordinate with other sectors of the Federal government, including the national security community, to address and respond to growing cyber risks?

Response:
The NCUA participates in several federal committees, councils, and working groups to coordinate with other sectors of the federal government on cybersecurity. These include the Federal Financial Institutions Examination Council (FFIEC) Task Force on Supervision, its Information Technology Subcommittee, and its Cybersecurity Critical Infrastructure Working Group. Additionally, in partnership with the Treasury Department, we also collaborate with the Financial and Banking Information Infrastructure Committee (FBIIC). The Treasury Department also facilitates collaboration among various other departments and agencies, including the Department of Homeland Security, the Secret Service, the Department of Justice, the Federal Bureau of Investigation, and the Department of Defense.

1(b) Additionally, please explain the extent your agencies coordinate with the financial sector (and other private and nonprofit entities) to address and respond to growing cyber risks?

Response:
A great deal of private sector collaboration occurs within the FBIIC's relationship with the Financial Services Sector Coordinating Council. The NCUA also participates with several financial sector organizations such as the Financial Services Information Sharing and Analysis Center and the National Credit Union Information Sharing & Analysis Organization. These groups focus on several areas of interest, including threat/hazard-related issues, public information and media, and internal capabilities.

1(c) Do you believe the current levels of coordination are sufficient or could they be enhanced in any specific way?

Response:
The current levels of cooperation are effective and continue to evolve in line with the mission and cybersecurity threat. The only significant exception at this time is in the area of vendor management, as the NCUA does not have third-party vendor authority like the other federal financial banking regulators.

2. Do you believe you have the statutory, regulatory, and supervisory tools necessary to ensure that cyber risks do not pose a threat to the financial system broadly, or to individual financial institutions specifically?

Response:
While nothing will eliminate all cyber threats, the NCUA utilizes rules and regulations authorized under the Gramm-Leach Bliley Act (GLBA) and associated tools to examine and supervise the information security programs of credit unions. While GLBA provides a substantial amount of statutory authority, it does not provide the NCUA with the vendor management authorities granted to the other federal financial banking regulators by the Bank Service Company Act. In addition, there is no single federal law to holistically address the cybersecurity challenges facing the entire financial services ecosystem. As such, even with several individual laws for the dependent sectors and sub-sectors, there are significant challenges, including propagating practices regarding multi-factor authentication, breach notification, safe handling of data transfer, and anonymizing collected data to protect privacy.

Response to Congressman French Hill

The U.S. Treasury Department issued their "Nonbank Financials, FinTech and Innovation" report in July 2018 which provides a thoughtful and comprehensive report on ways to maintain and enhance America's financial technology competitive edge.

Based on your experience and leadership regulating financial institutions across the country, what do you believe are the top issues from the report that Congress should be prioritizing as part of our work on the FinTech and AI task force?

Response:
The Treasury Department's report provided multiple insightful findings and recommendations that could help accelerate the adoption and development of fintech, while still protecting consumers and maintaining a safe and sound financial system. Specifically, I believe that Congress should prioritize removing uncertainties around data aggregation. As noted in the Treasury Department's report, the practice of using login credentials for screen scraping poses risks to both consumers and financial institutions. Instituting federal standards could remove legal and regulatory uncertainties, thereby promoting the use of application programming interfaces (APIs). As the report notes, APIs are potentially a more secure way for applications to access consumer financial data and Congress should consider additional legislation if necessary to ensure regulators have jurisdiction to effectively regulate these entities.

Additionally, creating agile and effective regulations to account for innovation will enable the federal financial banking regulators to be up-to-date on innovation in the financial services industry. The NCUA is in the process of creating an Office of Innovation and Access to identify and implement additional knowledge-building initiatives related to financial innovation. As noted in the Treasury Department's report, existing government regulations make it difficult for most federal agencies to acquire new and innovative technologies, either to research and test or to use for agency operations. Legislation enabling the NCUA to acquire innovative technology would enhance our ability to identify the potential risk exposure in the credit union system and allow the agency to utilize technological innovations that result in more efficient operations.

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Chairwoman Maxine Waters:

The Unbanked and Underbanked

The FDIC's most recent household survey on the banking industry showed that 8.4 million households, including more than 14 million adults, were "unbanked" in 2017. Of those unbanked, almost one-third said they simply did not trust banks. Americans continue to read headlines about megabanks like Wells Fargo and a litany of consumer abuses – millions of unauthorized accounts being opened, discriminatory lending practices, unwanted auto insurance that led to thousands of inappropriate car repossessions, more than 500 families mistakenly foreclosed on, etc. – while they continue to make billions of dollars in profit.

1) Chairman McWilliams, could these repeated misdeeds by a bank like Wells Fargo, especially when these megabanks and their executives are not held accountable, contribute to the lack of trust millions of Americans have in our nation's banks? In your opinion, if Wells Fargo was closer in size to a community bank with say less than $10 billion and committed the litany of consumer abuses but on a smaller scale, would the FDIC have tolerated its continued existence? Since the FDIC provides taxpayer-backed insurance to Wells Fargo, has your agency considered utilizing the authorities you have available to hold such a recidivist megabank accountable?

Response: A strong corporate culture that emphasizes transparency, compliance, and accountability is important at any financial institution, regardless of size. Unscrupulous practices that violate the law should and do have consequences. It is incumbent upon bank regulators to expect and demand accountability from the institutions they supervise.

This is of particular importance to the FDIC, as it identifies, monitors, and addresses risks not only with respect to the institutions for which we are the primary federal financial regulator (PFR) but also with respect to all insured depository institutions (IDIs).

The FDIC has a unique role as insurer, to understand the risks posed by all institutions. The FDIC carries out this role with respect to institutions for which it is not the PFR by reviewing reports of examination and other supervisory reports prepared by the PFR, participating in examination activities alongside the PFR, conducting independent examination activities when necessary, and monitoring institutions' financial conditions offsite through the regular collection of data.

In the case of Wells Fargo specifically, the Office of the Comptroller of the Currency (OCC) and the Consumer Financial Protection Bureau (CFPB) are the primary regulators charged with addressing weaknesses and shortcomings through supervisory and enforcement actions. During 2016, the OCC and CFPB took enforcement actions against Wells Fargo to address weaknesses, shortcomings and violations of law identified through their supervisory processes. These

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enforcement actions addressed illegal private student loan servicing practices, the illegal practice of secretly opening unauthorized deposit and credit card accounts, and violations of the Servicemembers Civil Relief Act.

In November of 2016, the OCC made the bank subject to the limitations of 12 C.F.R. 5.51 requiring prior written notice of a change in directors and senior officers and 12 C.F.R. Part 359 requiring prior approval of payments that would meet the definition of a golden parachute.

Most recently, in February 2018, in response to widespread consumer abuses and other compliance breakdowns, the Federal Reserve restricted Wells Fargo's growth until the firm improved its governance and controls. In addition to the growth restriction, the Federal Reserve's consent cease and desist order with Wells Fargo requires the firm to improve its governance and risk management processes, including strengthening the effectiveness of oversight by its board of directors. Until the firm makes sufficient improvements, it will be restricted from growing any larger than its total asset size as of the end of 2017. These actions remain in place. Wells Fargo replaced three directors in 2018 and is in search of a new Chief Executive Officer.

FDIC examiners participated in many of the examinations that identified the bank's shortcomings and fully supported each of the enforcement actions taken, particularly those directed to the bank's management. The FDIC has also participated in Wells Fargo Board of Directors' meetings with the other primary regulators.

On the issue of trust in our financial system, I can assure you that I recognize firsthand the importance of the public's trust in our banking system and its regulators. As a result, one of my first major initiatives as FDIC Chairman was a *Trust through Transparency* initiative that the FDIC launched in 2018 to strengthen the trust among consumers, financial institutions, and the FDIC while best positioning the FDIC to fulfill its important mission.[1]

This is particularly important as we seek to bring more unbanked and underbanked households into the banking fold. These households are often low- and moderate-income, a population that can benefit from the products, services, and protections that the formal banking system provides.

Our nation's banks are the center of economic activity in their communities. The ability of these banks to provide financial products and services to their customers forms the backbone of a strong national economy. It is a priority of the FDIC to strengthen the bonds of trust to ensure that banks are able to meet consumer needs and support communities across the country.

[1] *FDIC Transparency & Accountability* (Oct. 4, 2018), available at: https://www.fdic.gov/transparency/.

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Deregulating Megabanks – Capital, Leverage, Stress Testing, Living Wills

Soon after President Trump assumed office, he said that, "[W]e're going to do a big number on Dodd-Frank," and he tasked the Treasury Department to design the roadmap. Treasury issued a series of reports with dozens of deregulatory recommendations to roll back capital, leverage, stress testing and other safeguards, and Secretary Mnuchin recently said he was pleased at how regulators were implementing those suggestions.

To that end, regulators have advanced several proposals to change prudential requirements for the largest banks. In April 2018, the Federal Reserve issued a set of proposals to revise its capital rules for G-SIBs and introduced a "stress capital buffer," or SCB, which would in part integrate the forward-looking stress test results with the Board's non-stress capital requirements.[2] The Federal Reserve joined the OCC in releasing a second proposal to substantially alter the current enhanced supplementary leverage ratio (eSLR) that applies to G-SIBs.[3] The FDIC estimated the eSLR proposal would lower capital requirements for the primary federally-insured bank subsidiary of each G-SIB by a combined $121 billion. In October 2018, the Federal Reserve, FDIC and OCC released proposals to implement S. 2155 that would tailor the application of prudential standards to large banks, proposing to establish four categories of large banks based on asset size and cross-border activity.[4] In March 2019, the Federal Reserve decided not to deploy the countercyclical capital buffer that would require large banks to build additional capital,[5] and made revisions to the stress-testing regime to limit the use of the "qualitative objection,"[6] which may make it easier for large banks to pass their stress tests.[7] In April, regulators proposed easing prudential standards for foreign banks,[8] and modifying large bank resolution plans (referred to as "living wills") so that for many large banks would submit plans every three years.[9]

These proposals have received a range of criticisms, including opposition from Federal Reserve Governor Lael Brainard and FDIC Board Member Marty Gruenberg.[10] Former Federal Reserve Governor Dan Tarullo described these proposals as "low-intensity deregulation,"[11] explaining these roll backs come at a cost. In a research note by Fitch Ratings, analysts noted that a proposal issued recently by the Federal Reserve and FDIC to extend the living will deadlines for G-SIBs from annual submission to every other year

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[2] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.
[3] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm.
[4] https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20181031.pdf.
[5] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm.
[6] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm.
[7] Alan Rappeport and Emily Flitter, "Regulators Move to Ease Post-Crisis Oversight of Wall Street," New York Times (Mar. 6, 2019), https://www.nytimes.com/2019/03/06/business/bank-regulation.html.
[8] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm
[9] https://www.fdic.gov/news/news/press/2019/pr19035.html
[10] For example, see https://www.americanbanker.com/news/the-feds-lael-brainard-stands-alone and https://www.fdic.gov/news/news/speeches/spapr1218.html.
[11] https://ourfinancialsecurity.org/2019/05/speech-former-fed-governor-tarullo-decries-low-intensity-deregulation/

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would be a "negative" credit event for those financial institutions, writing, "As regulatory requirements continue to ease on the margin for the largest banks, risks inherent to their complexity can be further exacerbated by the loss of comparative data from annual resolution planning and stress testing data."

2) Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, please provide the Committee with a list of proposals that your agency has made, or is planning to make, that is responsive to recommendations by the Department of the Treasury in its series of regulatory reform reports and memoranda issued in 2017 and 2018.[12]

Response: The FDIC recognizes its mission to maintain stability and public confidence in the nation's financial system, including by examining and supervising financial institutions for safety and soundness and consumer protection. The FDIC has taken steps to appropriately tailor our supervision and regulation to take into account the size, complexity, and business model of financial institutions, while still ensuring safety and soundness. In doing so, the FDIC has considered input and feedback from a range of sources, including recommendations put forth by the U.S. Department of Treasury. Several of those steps we have taken are highlighted below:

- *De Novo* Application Process: The FDIC has revised the process for receiving and reviewing draft insurance applications.[13] The FDIC has also conducted significant outreach efforts, including issuing a Request for Information in the *Federal Register* to seek public comment on the process and holding several roundtable events across the country.[14]

- Community Reinvestment Act (CRA): Last year, the OCC solicited public feedback on how CRA regulations could be modernized and clarified. The FDIC, along with the Federal Reserve Board (FRB) and the OCC (collectively, the "federal banking regulators"), reviewed the comment letters received and we are working on a joint proposal for a revised CRA framework. Our focus is on clarifying what activities qualify for CRA consideration, reviewing how we assess lending by banks outside of their main offices and branches, and ensuring CRA investments target those most in need within the bank's community.

[12] https://home.treasury.gov/policy-issues/top-priorities/regulatory-reform.
[13] *See* FDIC, "FDIC Issues an Update to its Publication Entitled Applying for Deposit Insurance – A Handbook for Organizers of De Novo Institutions, et al." Financial Institution Letter 83-2018 (Dec. 6, 2018), available at https://www.fdic.gov/news/news/financial/2018/fil18083.html.
[14] *See* FDIC, "Request for Information on the FDIC's Deposit Insurance Application Process," 83 Fed. Reg. 63,868 (Dec. 12, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-12-12/pdf/2018-26811.pdf.

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- Appraisal Thresholds: On August 20, 2019, the FDIC approved a final rule to raise the threshold for residential real estate transactions and to incorporate exemptions from appraisal requirements for certain rural transactions.[15]

- Volcker Rule: On July 22, 2019, the federal banking regulators, as well as the Commodity Futures Trading Commission (CFTC) and the U.S. Securities and Exchange Commission (SEC), published a final rule to exclude community banks from the Volcker Rule.[16] On August 20, 2019, the Board of Directors of the FDIC approved an interagency final rule to simplify and tailor requirements related to the Volcker Rule.[17] The five agencies additionally plan to address restrictions related to covered funds in a future rulemaking.

- Capital and Liquidity Requirements: The FDIC has issued two interagency proposals to tailor the application of capital and liquidity requirements according to risk-based categories, one for domestic organizations and one for foreign banking organizations with total consolidated assets of $100 billion.[18,19] The FDIC has also issued an interagency proposal to amend the supplemental leverage ratio for custodial banking organizations and an interagency proposal to revise the definition of high-volatility commercial real estate exposure.[20,21] The federal banking regulators recently finalized a capital simplification rule to modify the treatment of mortgage-servicing assets, certain deferred tax assets, and investment in unconsolidated financial institutions.[22] The FDIC also

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[15] *See* OCC, FRB, FDIC, "Real Estate Appraisals" awaiting Federal Register publication (approved August 20, 2019) (to be codified at 12 C.F.R. pt. 323) available at https://www.fdic.gov/news/board/2019/2019-08-20-notice-sum-b-fr.pdf.
[16] *See* OCC, FRB, FDIC, CFTC, SEC "Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds" 84 Fed. Reg. 35,008 (July 22, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-22/pdf/2019-15019.pdf.
[17] *See* OCC, FRB, FDIC, SEC, CFTC "Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds," (Aug. 20, 2018), available at https://www.fdic.gov/news/board/2019/2019-08-20-notice-dis-a-fr.pdf?source=govdelivery&utm_medium=email&utm_source=govdelivery.
[18] *See* OCC, FRB, FDIC "Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements," 83 Fed. Reg. 66,024 (proposed Dec. 21, 2018) (to be codified at 12 C.F.R. pt. 324, 329), available at https://www.govinfo.gov/content/pkg/FR-2018-12-21/pdf/2018-27177.pdf.
[19] *See* OCC, FRB, FDIC "Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries," 84 Fed. Reg. 24,296 (proposed May 24, 2019) (to be codified at 12 C.F.R. pt. 324, 329), available at https://www.govinfo.gov/content/pkg/FR-2019-05-24/pdf/2019-09245.pdf.
[20] *See* OCC, FRB, FDIC "Regulatory Capital Rule: Revisions to the Supplementary Leverage Ratio to Exclude Certain Central Bank Deposits of Banking Organizations Predominantly Engaged in Custody, Safekeeping and Asset Servicing Activities," 84 Fed. Reg. 18,175 (proposed Apr. 30, 2019) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2019-04-30/pdf/2019-08448.pdf.
[21] *See* OCC, FRB, FDIC "Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures," 83 Fed. Reg. 48,990 (proposed Sept. 28, 2018) (to be codified at 12 C.F.R. 324), available at https://www.govinfo.gov/content/pkg/FR-2018-09-28/pdf/2018-20875.pdf.
[22] *See* OCC, FRB, FDIC "Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic

approved a final rule to implement an optional community bank leverage ratio for qualifying community banks.[23] This option would simplify the capital requirements for banks under $10 billion in consolidated total assets. Further, the federal banking regulators have also issued an interagency final rule to treat certain municipal obligations as high-quality liquid assets for purposes of calculating the liquidity coverage ratio.[24] Most of these changes were required by the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).

- Stress Tests: As required by EGRRCPA, the FDIC issued an interagency proposal to raise the minimum consolidated asset threshold for financial company-run stress tests to $250 billion.[25]

- Resolution Planning: The FDIC and FRB published a proposal for public comment that would modify the resolution plan requirements for large bank holding companies.[26] The proposal implements changes to resolution planning requirements under EGRRCPA and proposes exempting smaller regional banks from the rule, while still ensuring that submitted plans would remain subject to rigorous review.

- Examination Cycle: The FDIC increased the size threshold for eligible banks to qualify for an 18-month examination cycle from $1 billion to $3 billion in total assets.

3) Chairman McWilliams, your Republican and Democratic predecessors at the FDIC always pushed for higher capital requirements, especially for megabanks. Would financial stability be improved if megabanks were required to maintain more capital, consistent with research from the Fed, IMF and others, at a time when they are making record profits? Have you ruled out increasing capital requirements for the largest banks despite the benefits it would bring to the economy and the institution?

Response: Strengthening capital requirements at our nation's largest, most systemically important banks was an essential post-crisis response as strongly capitalized banks are better able to withstand financial and economic headwinds.

Growth and Regulatory Paperwork Reduction Act of 1996," 84 Fed. Reg. 35,234 (finalized July 9, 2019) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2019-07-22/pdf/2019-15131.pdf.

[23] *See* OCC, FRB, FDIC "Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations," awaiting Federal Register publication (approved September 17, 2019) (to be codified at 12 C.F.R. pts. 303, 324, 337, 347, 362, 365, and 390), available at https://www.fdic.gov/news/board/2019/2019-09-17-notice-dis-a-fr.pdf.

[24] *See* OCC, FRB, FDIC "Liquidity Coverage Ratio Rule: Treatment of Certain Municipal Obligations as High-Quality Liquid Assets," 84 Fed. Reg. 25,975 (proposed June 5, 2019) (to be codified at 12 C.F.R. pt. 329), available at https://www.govinfo.gov/content/pkg/FR-2019-06-05/pdf/2019-11715.pdf.

[25] *See* FDIC "Company-Run Stress Testing Requirements for FDIC-Supervised State Nonmember Banks and State Savings Associations," 83 Fed. Reg. 67,149 (proposed Dec. 18, 2018) (to be codified at 12 C.F.R. pt. 325) available at https://www.govinfo.gov/content/pkg/FR-2018-12-28/pdf/2018-27824.pdf.

[26] *See* FRB and FDIC "Resolution Plans Required," 84 Fed. Reg. 21,600 (proposed May 14, 2019) (to be codified at 12 C.F.R. pt. 381), available at https://www.govinfo.gov/content/pkg/FR-2019-05-14/pdf/2019-08478.pdf.

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I support robust capital standards; however, the stringency of these standards should be appropriately tailored to firms given their size, risk profile, and systemic importance. The Global Systemically Important Banks (G-SIBs) continue to be subject to the most rigorous standards. On-site examiners are in these banks every day, ensuring the banks are engaged in prudent risk management and have proper internal controls in place. In addition, these banks are subject to a complex framework of regulations, including standardized and advanced risk-based capital standards, market-risk capital standards, G-SIB capital surcharges, leverage ratios, supplementary leverage ratios, enhanced supplementary leverage ratios, liquidity coverage ratios, long-term debt requirements, stress testing, and mandatory clearing and margin requirements for derivatives. These banks are also subject to the Federal Reserve Board's Comprehensive Capital Analysis and Review (CCAR) exercise.

In addition to the minimum capital requirements, the FDIC expects every institution to maintain capital levels commensurate with the level and nature of all risks to which the institution is exposed. Firms must have a framework for assessing and governing their overall capital adequacy in relation to their risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

4) Chairman McWilliams, is the FDIC considering signing on to the Federal Reserve and OCC's proposal to rollback the enhanced Supplementary Leverage Ratio (eSLR), which according to your predecessors at the FDIC, could reduce bank capital by as much as $120 billion at the nation's largest banks?

Response: The enhanced Supplementary Leverage Ratio (eSLR) is an area that the federal banking regulators have been reviewing. Section 402 of EGRRCPA requires the three agencies to amend the supplementary leverage ratio for custodial banking organizations to address the treatment of certain deposits at central banks. The agencies issued an interagency proposal to address Section 402 in March 2019.[27] The FDIC will continue to monitor whether additional changes to capital and leverage rules are warranted.

5) Chairman McWilliams, why is the FDIC proposing to dial back the frequency of living wills for banks? How will that help ensure banks are not too big to manage let alone fail in an orderly way, and promote financial stability?

Response: Resolution plans have been a valuable tool for improving resolvability through bankruptcy. The planning process has helped ensure that firms can better project resource availability and needs in resolution, understand and simplify their legal structures, work through their internal governance processes, and address core obstacles to resolution in bankruptcy. Firms have made significant progress in this regard.

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[27] *See* OCC, FRB, FDIC "Regulatory Capital Rule: Revisions to the Supplementary Leverage Ratio To Exclude Certain Central Bank Deposits of Banking Organizations Predominantly Engaged in Custody, Safekeeping and Asset Servicing Activities," 83 Fed. Reg. 18,175 (proposed Mar. 29, 2019) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2019-04-30/pdf/2019-08448.pdf.

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For the largest U.S. G-SIBs, the agencies have been on an *ad hoc* two-year cycle for several cycles and found that it provides an appropriate amount of time to review plan submissions and provide constructive feedback that filers are able to meaningfully incorporate in subsequent plan filings. The FDIC and the FRB sought public comment on ways to update our resolution plan review process based on the progress made and lessons learned from previous review cycles.[28] Under the proposal, the agencies would establish a biennial filing cycle for the U.S. G-SIBs and extend the filing cycle to every three years for all other filers.

The proposal also recognizes and emphasizes the importance of firms' critical operations, which are those activities likely to have an adverse effect on U.S. financial stability if interrupted or discontinued. The proposal describes processes for the agencies and appropriate firms to follow to periodically review critical operations based on the size, complexity, and scope of a firm's operations. This allows the resolution planning process to accommodate the evolution of the markets and the firms' participation in those markets or activities.

Importantly, the proposal ensures rigorous resolution planning will continue at the largest, most complex firms; meaningfully tailors the rule for firms still subject to the rule that do not pose the same systemic risk as the largest institutions; and exempts a number of smaller, simpler firms that have less than the statutory $250 billion in total consolidated assets. These smaller, simpler firms, however, would not necessarily be exempt from all resolution planning requirements, as they would still be subject to the FDIC's rule requiring resolution planning for IDIs.

We believe that extending the resolution plan filing cycles on a more permanent basis strikes an important balance by ensuring the agencies have adequate time to review and provide substantive feedback to firms, facilitating firms' ability to incorporate such feedback, and preserving the important benefits of updated and ongoing resolution planning.

Bank Consolidation/Bank Merger Activity

Over the last decade, applications for bank mergers have been approved at record speed and with little opposition from regulators. From 2006 through 2017, over 3,800 merger applications were submitted to the Federal Reserve, yet the agency did not formally reject *any* merger application. Recently, BB&T announced its intent to merge with SunTrust, making it the sixth-largest bank in the United States. The deal is expected to close by year-end.

6) Chairman McWilliams, if the BB&T and SunTrust merger is approved, the new bank would become the largest bank ever under FDIC supervision. Is the FDIC prepared to supervise such a large bank? Are there any circumstances that would lead you to reject the proposed merger? If so, what would those circumstances be and how high a bar is it?

[28] *See* supra note 26.

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Response: The FDIC has implemented comprehensive and consistent supervisory oversight of insured institutions, including direct supervision of large institutions and backup supervision of the largest institutions in the country. Since the crisis in particular, the agency has significantly increased and enhanced its supervisory involvement, expertise, and practices for these institutions.

The FDIC's direct supervisory approach is tailored to address the size, complexity, and risk profile of each institution. In the case of larger, more complex institutions, the FDIC has a longstanding record of utilizing a continuous examination program. Under this supervisory program, dedicated staff conducts ongoing, on-site supervisory examinations and off-site institution monitoring. The program is designed to provide the depth of review and continuous monitoring that is necessary to plan for and respond appropriately to risks in larger institutions.

In addition to its direct supervisory approach, the FDIC has a team of senior examiners who participate in targeted examinations of the largest institutions in the country under the FDIC's special examination authority outlined in Section 10(b)(3) of the Federal Deposit Insurance FDI Act (FDI Act). The FDIC additionally has staff assigned to ongoing institution monitoring, which includes participating in meetings between the primary federal regulators and these institutions. Through these activities, the FDIC is an integral participant in the examination and supervision programs at the largest financial institutions in the country. Recently, the FDIC established a separate, single division dedicated to the FDIC's backup supervision, ongoing risk monitoring, and resolution planning: the Division of Complex Institution Supervision and Resolution.

FDIC staff is currently reviewing BB&T's application in accordance with established internal policy and applicable laws and regulations; therefore, it is premature to speculate on any outcome. If the proposed merger is approved and consummated, the FDIC is prepared to supervise the resultant bank. The FDIC Board of Directors will make the final decision on the application.

Specifically, merger transactions are considered under the framework of Section 18(c) of the FDI Act, 12 U.S.C. § 1828(c). The FDIC will fully consider all factors under that statutory framework, which include:

1. Whether the proposed merger transaction would result in a monopoly;

2. Whether the effect of the proposed merger in any section of the country may be to substantially lessen competition or tend to create a monopoly, or in any other manner restrain trade, unless the responsible agency finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;

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3. The financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the risk to the stability of the United States banking or financial system;

4. The effectiveness of any IDI involved in the transaction in combatting money laundering activities, including in overseas branches; and

5. Whether, upon consummation of the transaction, the resulting IDI would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

Fintech

There has been tremendous interest in financial technology, or fintech, and the Committee has formed two task forces to more closely examine fintech and AI.

7) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles: GAO issued a recent report making a series of recommendations that the regulators coordinate better on fintech issues.[29] Please outline what specific steps is your agency taking to respond to these recommendations, and coordinate better with other regulators?

Response: The FDIC recognizes the benefits of engaging in collaborative discussions on fintech matters with other relevant regulators, and does so through venues like the Federal Financial Institutions Examination Council (FFIEC), the Financial Stability Oversight Council (FSOC), and an Interagency Fintech Discussion Forum. The FDIC has also engaged extensively with industry stakeholders, including financial institutions, consumer groups, trade associations, and financial technology companies, often on an interagency basis. On the international front, the FDIC coordinates with domestic and international counterparts as part of the Basel Committee on Banking Supervision's Task Force on Financial Technology. With regard to financial account aggregation in particular, the FDIC has been involved in ongoing collaborative discussions with other financial regulators, including interagency discussions to address the GAO recommendation.

8) Chairman McWilliams, some fintech companies have explored getting an Industrial Loan Company (ILC) charter, which has not been granted in more than a decade. Is an ILC charter appropriate for fintech companies? Is there anything preventing Amazon or Google from getting a charter? Given the concerns raised by a range of stakeholders, including consumer advocates and community banks,[30] will the FDIC hold public hearings

[29] https://www.gao.gov/products/GAO-18-254.
[30] For example, see https://www.icba.org/docs/default-source/icba/advocacy-documents/reports/ilc-white-paper.pdf?sfvrsn=ea6f4317_2 and https://ncrc.org/wp-content/uploads/2017/10/ncrc%20comment%20on%20square%20industrial%20bank%20charter%20application.pdf
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on any application it considers to ensure the public has a robust opportunity to share their perspectives with the agency?

Response: Organizing groups determine what charter type they will seek for a proposed institution: a state charter issued by a state banking authority or a national charter issued by the OCC. The decisions of the organizing group may reflect consideration of multiple factors, such as the proposed business strategy and model, customer markets and geographic reach of the institution's operations, and the organizational structure within which the institution would operate.

With respect to commercial firms obtaining charters, generally, commercial firms may own or control certain financial institutions if the activities are limited to those consistent with the Competitive Equality Banking Act, as is the case with Industrial Loan Companies (ILCs). As with any deposit insurance application, the FDIC reviews the proposal in relation to the statutory authority set forth in Section 6 of the FDI Act.

FDIC Rules and Regulations require applicants to publish for public comment information regarding applications subject to the CRA. Publication is intended to inform the general public regarding the respective submission and provides the public an opportunity to submit comments to the FDIC.

Determinations regarding public hearings or other meetings are made on a case-by-case basis. Section 303.10 of the FDIC's Rules and Regulations addresses hearings and informal proceedings, and provides that the FDIC will generally grant a hearing or informal proceeding request if the FDIC determines that written submissions would be insufficient, or that such a proceeding is in the public interest.[31]

9) Chairman McWilliams, what are your views on "open banking"? Other countries seem to be pursuing this approach to ensure consumers have full access and control of their personal information, and can use new mobile applications to do a better job shopping for the best financial products and services. What are the pros and cons of promoting "open banking" in the United States?

Response: The FDIC recognizes the potential benefits that open banking can provide in terms of innovation and competition, and the need to balance these benefits with the potential impacts on safety and soundness, consumer protection, and other risk considerations.

Consumers are increasingly interested in sharing their financial account data with third parties, including fintech companies that provide services such as personal financial management, budgeting, and savings. Firms also utilize consumer-permissioned data for account verification, loan application verification, credit decision making, and other purposes.

[31] 12 C.F.R. §303.10.

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While there are many benefits to open banking, there are also risks. The FDIC, along with the other agencies, has been engaged with stakeholders (including banks, data aggregators, fintechs, and consumer groups) on this issue for a number of years. Key topics that frequently arise in stakeholder discussions include cybersecurity, liability, consumer privacy, and consumer's ability to control their own data, among others. We are continuing to engage on these issues as the marketplace further evolves.

Volcker Rule

I would like to discuss recent statements by all of you about banking regulators making headway on efforts to streamline Volcker Rule compliance. It seems that these statements rarely offer any specifics.

10) Chairman McWilliams, in recent remarks by you at the Institute of International Bankers Annual Conference,[32] you state that there is broad consensus on the need to make changes to the Volcker Rule. You stated that a revised rule should provide more certainty to regulated entities and should clarify how the FDIC defines the types of trading that are prohibited and the kinds of funds that are within the scope of the rule. Do you agree that taxpayers should not provide a backstop for banks engaged in proprietary trading? Is that what the federal safety net is designed for?

Response: Congress decided the appropriate role for proprietary trading within the banking system when the Volcker Rule was passed as part of the Dodd-Frank Act in 2010. It is the responsibility of the FDIC and the other banking regulators to faithfully implement its provisions as the statute requires. It is also prudent to periodically review our regulatory framework and contemplate changes when appropriate.

Since the passage of the Volcker Rule as part of the Dodd-Frank Act, federal regulators have wrestled with the complex task of how to implement it. In fact, the rule has turned out to be so complex that it required 21 sets of frequently asked questions (FAQs) issued by the regulators within three years of its adoption. Distinguishing between what qualifies as proprietary trading and what does not has proven to be extremely difficult for both the regulated entities and the regulators. All five federal regulators tasked with implementing the Volcker Rule have stated that the prohibitions on proprietary trading and on the ownership of covered funds can be simplified, in part to assist federal regulators in focusing resources on prohibited proprietary trading.

The final rule approved by the FDIC Board of Directors in August simplifies the rule, reduces the amount of subjectivity in its implementation, and provides more clarity, certainty, and objectivity to market participants while remaining faithful to our statutory responsibilities.[33]

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[32] https://www.fdic.gov/news/news/speeches/spmar1119.html.
[33] *See* OCC, FRB, FDIC, SEC, and CFTC, "Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" awaiting Federal Register

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Under the final rule, firms with a significant level of trading activity will remain subject to the most stringent compliance requirements, while those firms with lower amounts of trading activity will be subject to tiered compliance programs. The agencies estimate that banking entities classified as having significant trading activity hold approximately 93 percent of the trading assets and liabilities in the U.S. banking system, or approximately 99 percent if combined with the trading assets and liabilities of those banking entities classified as having moderate trading activity. The final rule thus reflects the fact that the overwhelming majority of activity covered by this final rule is conducted by relatively few banks.

The five agencies plan to address restrictions related to covered funds in a future rulemaking.

Community Reinvestment Act

The Community Reinvestment Act ("CRA") was designed to equalize the financial playing-field by encouraging banks to meet the credit needs of consumers in low income neighborhoods. Specifically, the CRA was designed to address discriminatory policies such as redlining. Unfortunately, Reveal by the Center for Investigative Reporting published several articles after its yearlong investigation based on 31 million records publicly available under the Home Mortgage Disclosure Act ("HMDA") to identify lending disparities.[34] According to their reporting, "Fifty years after the federal Fair Housing Act banned racial discrimination in lending, African Americans and Latinos continue to be routinely denied conventional mortgage loans at rates far higher than their white counterparts." Specifically, the data showed black applicants were turned away at significantly higher rates than whites in 48 cities, Latinos in 25, Asians in nine and Native Americans in three. Their investigation found modern-day redlining in 61 metro areas across the country.

11) Comptroller Otting and Chairman McWilliams, what are the ways CRA can be improved so that minority depository institutions are able to play a larger role in addressing a lack of affordable credit in too many of our communities?

Response: The federal banking regulators are currently undertaking a comprehensive review of the CRA regulations and have been reaching out to all stakeholders as we consider possible revisions. During this process, the FDIC has continued to emphasize that any revisions to CRA regulations continue to focus on the needs of low- and moderate-income (LMI) communities and individuals, as well as the role Minority Depository Institutions (MDIs) may be able to play to expand access to affordable credit.

The vitality of MDIs is critical, given their role in the economic well-being of the minority and traditionally underserved communities many MDIs serve. The FDIC embraces its statutory

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publication (approved August 20, 2019) (to be codified at 12 C.F.R. pt. 351) available at https://www.fdic.gov/news/board/2019/2019-08-20-notice-dis-a-fr.pdf.
[34] https://www.revealnews.org/article/for-people-of-color-banks-are-shutting-the-door-to-homeownership/ and https://www.revealnews.org/article/gentrification-became-low-income-lending-laws-unintended-consequence/.

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responsibility to preserve and promote the health of MDIs and we are undertaking a comprehensive internal review of FDIC policies and procedures for providing technical assistance to MDIs to determine if additional support for MDIs can be provided. The FDIC has already increased our support for and emphasis on the MDIs by:

- Appointing a full-time, permanent executive to manage FDIC's MDI programs across the FDIC in 2018;
- Increasing the representation of MDIs on the FDIC's Community Bank Advisory Committee (CBAC) in 2019[35];
- Establishing a new MDI subcommittee on the CBAC this fall to both highlight MDIs' efforts in their communities and to provide a platform for MDIs to exchange best practices[36];
- Hosting the 2019 Interagency MDI and Community Development Financial Institution (CDFI) Bank Conference in June to highlight about the many ways MDIs and CDFIs can create positive change in their communities[37];
- Hosting the first of several roundtables with MDIs and non-MDIs supervised by the FDIC in June to share expertise and to promote possible collaborative opportunities, including direct investments and deposits in MDIs[38];
- Publishing a research study on the impact of MDIs in their communities, particularly in providing mortgage credit, SBA-guaranteed business loans, and other banking services[39]; and
- Continuing to provide technical assistance to groups seeking to organize new MDIs, and to existing MDIs to support their efforts to acquire failing institutions.

12) Chairman McWilliams, is the FDIC planning to follow Treasury's recommendation and implementing OCC's guidance to minimize or ignore fair lending violations in a CRA exam?

Response: The FDIC continues to follow long-standing interagency procedures for the treatment of fair lending violations in the CRA evaluation. CRA rules require the regulators to consider the scope and scale of compliance and fair lending violations, and related bank controls and corrective action, when assigning a rating. Specifically, the regulation states: "In determining the effect of evidence of [illegal credit] practices . . . on the bank's assigned rating, the FDIC considers the nature, extent, and strength of the evidence of the practices; the policies and procedures that the bank (or affiliate, as applicable) has in place to prevent the practices; any corrective action that the bank (or affiliate, as applicable) has taken or has committed to take,

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[35] *See* FDIC, "FDIC Announces New Members for the Advisory Committee on Community Banking." (March, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19024.html.
[36] *See* FDIC, "FDIC Hosts Interagency Conference Focusing on Minority Depository Institutions, Announces New MDI Initiatives and Publishes Results of New MDI Study." (June, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19054.html.
[37] *See* https://www.fdic.gov/regulations/resources/minority/events/interagency2019/.
[38] *See* FDIC, "FDIC Hosts Roundtable on Collaborations with Minority Depository Institutions." (June, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19057.html.
[39] *See* FDIC, "2019 Minority Depository Institutions: Structure, Performance, and Social Impact." (June, 2019). Available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

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including voluntary corrective action resulting from self-assessment; and any other relevant information."[40] In addition, based on interagency examination procedures, FDIC examiners "review the results of the most recent compliance examination and determine whether evidence of discriminatory or other illegal credit practices that violate an applicable law, rule or regulation should lower the institution's preliminary overall CRA rating...."[41] The CRA regulations and the current interagency exam procedures provide an effective mechanism through which the agencies consider the impact of discriminatory or other illegal credit practices on a bank's CRA evaluations.

Payday Loans and Small Dollar Credit

Some of the biggest concerns regarding payday loans and the small dollar credit industry are that consumers end up in "debt traps" whereby consumers are borrowing one loan to pay off another. On April 30th, our Consumer Protection and Financial Institutions Subcommittee held a hearing entitled "Ending Debt Traps in the Payday and Small Dollar Credit Industry." Rev. Dr. Haynes from the Friendship West Baptist Church in Dallas, TX, testified about one his congregants, stating "One of my members, a 74-year-old senior citizen, who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer. Now she feels like the devil answered her prayer. She is on a fixed income and when the repayment was due, she didn't have enough and had to take out another loan to pay the first one. She ended up with a dozen loans. When she approached me for help one Sunday after church, this once proud senior saint with good credit, was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620%! She was "dealt a bad hand with a bad plan." She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse."

13) Chairman McWilliams, is the FDIC considering rescinding its small dollar loan guidance that is currently in place encouraging small dollar loans with APRs of no more than 36%? Is the FDIC considering allowing deposit advance products that proved harmful before? Please describe your policy priorities in the small dollar lending space to ensure there are robust safeguards so that consumers are not caught in a debt trap, similar to what we have seen with payday and car title loan products.

Response: The FDIC is looking for ways to encourage banks to meet small-dollar credit needs in a manner that makes sense for both the bank and the consumer. Specifically, in November 2018, we issued a Request for Information seeking public input on small-dollar credit products.[42] We asked questions on a range of topics, including what legal and regulatory impediments exist that may discourage banks from offering small-dollar credit products. We received valuable information through this process and are using this feedback to formulate a revised policy

[40] 12 CFR 345.28(c).
[41] FDIC Compliance Examination Manual, XI: Community Reinvestment Act, Page 4.10.
[42] *See* FDIC "Request for Information on Small-Dollar Lending," 83 Fed. Reg. 58,566 (Nov. 20, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf.

framework that can help institutions develop small-dollar loan programs that meet their business needs, while being safe, accessible, and understandable for consumers.

Generally, consumers benefit when they can obtain small-dollar credit from banks, particularly at banks that have longstanding relationships with their local customers and communities. These banks are often well suited to offer small-dollar loan customers other types of products and services, such as car loans and mortgages, once the customer relationship has been established. Importantly, the federal banking regulators and the CFPB regulate banks for compliance with consumer laws and the agencies have both supervisory and enforcement tools at our disposal to address violations of consumer laws at individual banks. Unfortunately, some banks have elected not to offer such products for a variety of reasons, including regulatory considerations. As a result, many families have been relying on non-bank providers to cover these emergency expenses, as appears to be the case with Rev. Dr. Haynes' congregant.

Ultimately, as a matter of public policy and for the purposes of consumer protection, we should continue to encourage unbanked and underbanked consumers to enter the banking system. To facilitate this, we must understand what products appeal to unbanked and underbanked consumers, ensure such products are affordable and available, and avoid creating a regulatory environment that prevents our institutions from offering such products. We also must recognize that, generally, banks will not offer products from which they are unable to make a profit, especially if such products are also exposing them to significant potential regulatory and legal liability, reputational risk and a potentially negative market reaction. Rather, we should allow and encourage banks to innovate in this area to meet the needs of their customers.

The federal banking regulators are working together to create a small-dollar loan policy framework to provide banks more regulatory clarity and consistency with respect to these products. We also plan to engage with the CFPB. The FDIC expects to provide more information to the public about our small-dollar loan policy framework in the coming months.

14) Comptroller Otting, Chairman McWilliams, Chairman Hood, and Vice Chairman Quarles, what kinds of measures can you as regulators put in place to ensure that banks aren't charging interest rates above 36%?

Response: In response to the November 2018 Request for Information, the FDIC heard from a number of industry commenters that they would like to offer small-dollar credit products, but that an interest rate of 36 percent presented challenges in terms of being able to cover the operational costs of such products.[43] As discussed above, the FDIC is currently engaged in discussions with other federal banking regulators to provide more clarity and consistency to FDIC-supervised institutions.

[43] *Id.*

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Diversity and Inclusion - FDIC

According to FDIC's 2018 OMWI report, involuntary and voluntary attrition rates at FDIC are higher for Black men and women than any other racial group.

15) Chairman McWilliams, what reasons have you identified as to why FDIC is still struggling to attract and retain diverse talent?

Response: The FDIC's 2018 Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress details attrition rates for its Corporate Employee Program (CEP), not the agency's population as a whole.[44] The recruitment of examiners, the FDIC's largest occupational group, is conducted primarily through the CEP. The CEP trains the FDIC's workforce of Financial Institution Specialists, beginning as examiners-in-training, in a variety of areas.

Over the life of the CEP, which was launched in 2005, the FDIC has hired above the occupational Civilian Labor Force (CLF) benchmark for African Americans. However, retention for this population remains a challenge. Using a CEP Data Group, the FDIC has made efforts to remain informed on this issue. Over the past few years, the annual attrition gap between African Americans and non-African Americans in the CEP has lessened, but despite that improvement, we recognize the need to continue to engage with our employees to better understand and address retention issues in the CEP.

The examiner workforce is very mobile and the amount of travel and work-life balance have often been cited as issues across the board. Consequently, we are continuing to seek input from employees, including through the Chairman's Diversity Advisory Councils (CDACs), made up of employees from all segments of the agency, as well as our Employee Resource Groups (ERGs), particularly our African-American ERGs, to better understand and address challenges facing African Americans within the workforce.

With regard to the overall FDIC workforce, over the five past fiscal years, the FDIC has hired above or within one percentage point of the CLF benchmark for African Americans, and African Americans are represented in the organization at rates well above the CLF. Over the past five years, the total percentage of separations for African Americans has been within two percentage points of the expected rate based on representation within the workforce, and in line with that of other groups. For four of the last five fiscal years, the difference between the rate of separation of African Americans compared to the expected rate has been less than one percentage point.

The FDIC's Office of Minority and Women Inclusion (OMWI) initiated a barrier analysis in 2017 to determine if any barriers exist for women and minorities at the most senior grade level,

[44] *See* FDIC "2018 Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress," (Mar. 2019), available at https://www.fdic.gov/about/diversity/pdf/rtc32919.pdf.

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Executive Manager (EM). The FDIC is undergoing this process as a part of the Equal Employment Opportunity Commission (EEOC) Management Directive 715. The goal of the barrier analysis is to identify and eliminate, if found, any root causes or disparities in equal employment opportunities at the senior grade level. The barrier analysis process is a multi-year, multi-step process. The four steps are:

1) Identifying triggers,
2) Investigating to pinpoint potential barriers,
3) Developing action plans to eliminate any barriers identified, and
4) Assessing the effectiveness of actions plans.

In addition, following a thorough study of our processes for recruiting, hiring, and training examiners, we recently decided to implement changes to the entry-level examiner hiring process. The changes are intended, in part, to address attrition among new examiners. As a part of this change, we are creating an executive level task force to focus on strengthening the FDIC's ability to attract, retain, and advance a diverse examiner workforce, and to create and maintain a more inclusive workplace. In addition, a minority recruitment task force composed of FDIC Corporate Recruiters across all of our regions has been created to develop recruitment strategies to attract a more diverse applicant pool.

16) Chairman McWilliams, what information have you gathered from your OMWI director as well as from former and current employees about ways to increase promotion opportunities, mentoring and other diversity best practices that could result in better retention rates among Black employees and other minorities at FDIC?

Response: The FDIC has a Diversity and Inclusion (D&I) Executive Advisory Council (EAC), which includes agency senior executives. This group serves as a resource to the Chairman, the Deputy to the Chairman and Chief Operating Officer, and the OMWI Director in connection with the FDIC's diversity and inclusion goals and efforts.

In addition to the D&I EAC, the FDIC also has established Chairman's Diversity Advisory Councils (CDACs), which are made up of employees from across the agency. CDAC representatives brief the D&I EAC regarding national diversity and inclusion issues on an annual basis. Within the last year, the CDACs briefed me and the D&I EAC on issues that affect career progression and retention, including but not limited to work-life balance, safe spaces to raise workplace issues, disability identification, and diversity among executive leadership. FDIC management, through the OMWI Director, provided a written response to the CDACs detailing actions taken or planned to address issues raised, and the agency will continue to evaluate offerings to promote career development and succession planning, including External Leadership Development Programs, internal leadership courses and electives available through the FDIC's Corporate University, as well as participation in mentoring and executive coaching programs. Additionally, the FDIC continues to seek input from our ERGs, particularly our two African American employee groups.

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I have joined the OMWI Director at separate meetings of the CDACs, the ERGs, and the D&I EAC where we have discussed a wide range of diversity and inclusion issues, including but not limited to promotion opportunities, mentoring, and diversity best practices. In addition, I have had separate conversations with the OMWI Director on these issues, as well as with employees.

The OMWI Director will also serve as a member of the new executive committee governing entry level examiner hiring. The Director will advise on development and implementation of strategic initiatives to support recruitment sources, hiring processes, retention efforts, and advancement pools that reflect a purposeful and intentional effort to promote diversity and inclusion. The executive committee will provide me with periodic updates on those efforts and their impact.

The FDIC's 2018 OMWI report mentions that the agency began updating its 2014 study, titled "Minority Depository Institutions: Structure, Performance, and Social Impact," and that the updated report is due for publication in 2019.

17) Chairman McWilliams, when exactly is the report scheduled for release, and what new data, if any, will be included in the updated report?

Response: The FDIC released its 2019 research study, "Minority Depository Institutions: Structure, Performance, and Social Impact," on June 25, 2019, at the 2019 Interagency MDI and Community Development Financial Institution (CDFI) Bank Conference.[45] The report explores changes in FDIC-insured MDIs over the period 2001–18, their role in the financial services industry, and their impact on the communities they serve. The 2019 report adds five more years of data (2014–18) on the demographics, structural change, geography, financial performance, and social impact of MDIs. The 2019 study also incorporates data on Small Business Administration (SBA) 7(a) program-guaranteed loans that are originated by minority banks, and compares MDIs and non-MDIs based on the loans they make to low- and moderate-income census tracts and the minority populations in census tracts where loans are made.

18) Chairman McWilliams, what new opportunities will leaders at minority deposit institutions be able to take advantage of as a result of the latest study findings?

Response: When the FDIC released the 2014 study, leaders at MDIs shared that they found the report helpful for them in discussions with policymakers, investors, customers, and other stakeholders. In particular, they appreciated the section of the report that shows the significant impact MDIs have had in providing banking services to low- and moderate-income and minority communities compared to non-MDIs. The 2019 update should provide similar value to MDIs. In addition, MDI leaders may find beneficial value in the following actions undertaken by the FDIC to date:

- The appointment of a full-time, permanent executive to manage FDIC's MDI programs across the FDIC in 2018;

[45] *See* FDIC, "Minority Depository Institutions: Structure, Performance, and Social Impact," (June 2019), available at https://www.fdic.gov/bank/analytical/quarterly/2014-vol8-3/mdi-study.pdf.

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- Increased representation of MDIs on the FDIC's Community Bank Advisory Committee (CBAC) in 2019[46];
- The establishment of a new MDI subcommittee on the CBAC this fall to both highlight MDIs' efforts in their communities and to provide a platform for MDIs to exchange best practices[47];
- The 2019 Interagency MDI and Community Development Financial Institution (CDFI) Bank Conference in June that highlighted the many ways MDIs and CDFIs can create positive change in their communities[48];
- The first of several roundtables with MDIs and non-MDIs supervised by the FDIC held in June to share expertise and to promote possible collaborative opportunities, including direct investments and deposits in MDIs[49]; and
- Continued technical assistance to groups seeking to organize new MDIs, and to existing MDIs to support their efforts to acquire failing institutions.

19) Chairman McWilliams, if the report release is delayed, what preliminary findings can FDIC share in the interim?

Response: The report has been completed, and was released on June 25, 2019. The FDIC issued a press release and a link to the report on the FDIC's public website at www.fdic.gov/mdi.

Diversity and Inclusion – Full Panel

In June 2015, your agencies along with the SEC and the CFPB adopted the Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies. Despite urging from many Democrats that those standards for diversity assessments be mandatory and publicly disclosed by regulated entities, the final standards were voluntary, leaving an opportunity for continued opaqueness about industry diversity and inclusion. Under the voluntary standards, our review of your most recent OMWI reports reveals that each of your agencies have low participation by your regulated entities in completing the requested diversity and inclusion self-assessment. For example, among your respective regulated depository institutions, only 16% reported to FDIC; 9.3% reported to OCC; 6.0% reported to the Fed; and a mere 1.5% reported to NCUA the results of their diversity self-assessments.

20) Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman

[46] *See* FDIC, "FDIC Announces New Members for the Advisory Committee on Community Banking." (March, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19024.html.
[47] *See* FDIC, "FDIC Hosts Interagency Conference Focusing on Minority Depository Institutions, Announces New MDI Initiatives and Publishes Results of New MDI Study." (June, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19054.html.
[48] *See* https://www.fdic.gov/regulations/resources/minority/events/interagency2019/.
[49] *See* FDIC, "FDIC Hosts Roundtable on Collaborations with Minority Depository Institutions." (June, 2019). Available at https://www.fdic.gov/news/news/press/2019/pr19057.html.

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Quarles, what plans have you discussed with your OMWI directors and your regulated entities about how to increase participation in providing diversity self-assessments?

Response: The FDIC remains proactive in our outreach to encourage financial institutions to participate in the diversity self-assessment process. Annually, we send letters to the Presidents and Chief Executive Officers of FDIC-supervised financial institutions announcing the self-assessment and encouraging participation. A reminder letter is sent to encourage FDIC-regulated financial institutions that have not already submitted to complete a self-assessment on their diversity policies and practices.

To encourage greater participation in the self-assessment, the FDIC also developed an online portal to access the diversity toolkit and provide guidance on using the assessment tool and respond to anticipated questions from financial institutions.[50] The FDIC conducts analyses of the diversity self-assessments we receive and the results are posted online, summarizing responses and sharing exemplary practices. In 2019, the FDIC's OMWI Director recorded a video message on our public Diversity and Inclusion webpage, promoting the benefits and importance of regulated financial institutions completing and submitting their self-assessments.

The FDIC's OMWI also participates in banker outreach events to discuss the importance of conducting the diversity self-assessments. In September 2018, the FDIC co-hosted the "Financial Regulatory Agencies' Diversity and Inclusion Summit" in New York, NY. The summit is a forum to highlight industry diversity leading practices identified through the self-assessments.

The FDIC will continue to pursue opportunities, independently and in partnership with the other OMWI agencies, to promote participation in the diversity self-assessment process.

21) For the diversity data that has been shared, what type of analysis and advice, if any has been shared about regulated entities' diversity and inclusion efforts?

Response: The analyses of the 2016 and 2017 diversity self-assessments are available on the FDIC Financial Institution Diversity web portal. The self-assessment data is reported in the aggregate and not by individual financial institution. The goal of posting the analyses and related information is to highlight trends and to share exemplary practices to assist regulated entities in strengthening their diversity programs.

22) What type of guidance has been provided to bank examiners on how to evaluate diversity and inclusion practices at regulated entities?

Response: In developing the self-assessment approach, the OMWI agencies considered the rule of construction in Section 342(b)(4) of the Dodd-Frank Act, which provides that the standards prescribed by Section 342(b)(2)(C) may not be construed to require any specific action based on

[50] *See* Guidance for Completing the Diversity Self-Assessment (2010). Available at https://www.fdic.gov/about/diversity/guidance.html.

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the findings of the assessments. Accordingly, the FDIC and other OMWI agencies concluded that it would be inappropriate to utilize the examination or supervision processes to assess the diversity policies and practices of regulated entities, or use existing disclosure authority to require reporting on diversity practices. Thus, the FDIC's financial institution examiners are not involved in the diversity self-assessment process.

23) At your agencies, who do OMWI directors report to and to what extent are OMWI directors and other leadership at your agencies, including you, accountable for diversity results?

Response: At the FDIC, the OMWI Director is a member of the senior leadership team and reports to the Office of the Chairman. OMWI Director Saul Schwartz meets regularly with the Deputy to the Chairman and Chief Operating Officer and advises the FDIC Chairman on policies and practices to promote the advancement of diversity and inclusion throughout the agency. The Deputy to the Chairman and Chief Operating Officer chairs the D&I EAC, which includes the OMWI Director, FDIC division and office directors, and other key senior leaders. The D&I EAC meets regularly throughout the year to discuss diversity and inclusion issues and performance goals, and also monitors the implementation of the FDIC's *Diversity and Inclusion Strategic Plan.*[51]

The FDIC links the successful achievement of corporate performance goals regarding specific diversity and inclusion objectives to managers' performance. All divisions and major offices have diversity and inclusion strategic plans for their organizations that are guided by and aligned with the FDIC's *Strategic Plan.* Managers are rated on their support of all of the FDIC's performance goals, including those related to diversity and inclusion.

Incentive-Based Compensation

The Wells Fargo fraudulent account scandal, and its incentive-based cross-selling strategy that fueled it, is a stark reminder how important it is for financial regulators to finalize executive compensation rules. As you know, Section 956 of the Dodd-Frank Act directed the regulators to adopt joint rules aimed at prohibiting incentive compensation arrangements that could encourage inappropriate risks at financial institutions. The regulators made an initial proposal in 2011, then reworked the proposal and issued a new plan in 2016. The proposal increases in stringency based on the financial company's asset size with enhanced requirements for senior executive officers and significant risk-takers.

24) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, there was much discussion at the hearing regarding the fast implementation of S. 2155 enacted by the 115th Congress. However, there are a few much older mandates that your agencies have not yet finalized. For example, given that Section 956 of the Dodd-

[51] *See* FDIC, "FDIC Diversity and Inclusion Strategic Plan 2018-19." (2018). Available at https://www.fdic.gov/about/diversity/pdf/2018plan.pdf.

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Frank Act regarding incentive-based compensation is not a discretionary requirement, but a mandatory one, what steps are each of your agencies taking to prioritize the rule's implementation and enforcement this provision of the law?

Response: The Interagency Guidelines Establishing Standards for Safety and Soundness[52] (Part 364 Appendix A) currently prohibit compensation that is excessive or that could lead to material financial loss to an institution and describes such compensation as an unsafe and unsound practice, in accordance with Section 39 of the FDI Act.[53] Part 364 Appendix A states that compensation shall be considered excessive when amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. The banking agencies issued the Interagency Guidance on Sound Incentive Compensation Policies[54] in 2010 to help bank Boards of Directors ensure that incentive compensation arrangements appropriately balance risk and reward; are compatible with effective controls and risk management; and are supported by strong corporate governance.

The FDIC is engaged in an interagency working group working on implementation of section 956 of the Dodd-Frank Act. In the meantime, the FDIC continues to review compensation policies and practices of IDIs in accordance with the FDI Act[55] as well as the 2010 Interagency Guidance on Sound Incentive Compensation Policies to ensure that there is an appropriate risk management framework in place, including appropriate oversight and governance by the bank's Board of Directors and sound operational controls.

25) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, please provide the Committee with a timeline for each specific mandate required by S. 2155 from the 115th Congress and the Dodd-Frank Wall Street Reform and Consumer Protection Act that requires a rulemaking that your agency has yet to be finalized.

Response: The FDIC Board has approved final rules implementing all mandates in S.2155 other than those provided below:

- **Section 214 - Promoting construction and development on Main Street**
  In the interagency statement issued on July 6, 2018, the agencies acknowledged that Section 214 was effective upon enactment and indicated that a depository institution was permitted to risk-weight at 150 percent only those commercial real estate exposures that it believed met the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan."

[52] *See* 12 C.F.R. § 364.100 Appendix A (2019). Available at https://www.govinfo.gov/content/pkg/CFR-2019-title12-vol6/xml/CFR-2019-title12-vol6-part364.xml.
[53] *See* 12 U.S.C. § 1831p-1 (2019).
[54] *See* OCC, FRB, FDIC, OTS "Guidance on Sound Incentive Compensation Policies," (June 25, 2010). Available at https://www.govinfo.gov/content/pkg/FR-2010-06-25/pdf/2010-15435.pdf.
[55] *See* supra note 53.

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Alternatively, the agencies indicated that a depository institution could also continue to report and risk-weight high volatility commercial real estate (HVCRE) exposures in a manner consistent with the current instructions to the Consolidated Reports of Condition and Income until the agencies took further action.

In September 2018, the agencies issued a notice of proposed rulemaking that revises the definition of HVCRE to conform to the statutory definition of HVCRE ADC loan, in accordance with Section 214.[56] The public comment period closed on November 27, 2018. In response to comments the agencies issued a second proposed rule on July 23, 2019 that would expand upon the initial proposal to clarify that loans that solely finance the development of land for residential properties would meet the revised definition of HVCRE.[57]

- **Section 401 - Enhanced supervision and prudential standards for certain bank holding companies**
  In a statement issued on July 6, 2018, the FRB provided that it would not enforce certain regulations and reporting requirements for firms with less than $100 billion in total consolidated assets, such as rules implementing enhanced prudential standards and the liquidity coverage ratio requirements. This position was consistent with S. 2155's amendments to Section 165 of the Dodd-Frank Act and provided immediate relief to firms with less than $100 billion in total consolidated assets.

  In December 2018, the agencies jointly issued a separate notice of proposed rulemaking that would apply a revised framework for determining applicability of capital and liquidity requirements for large U.S. banking organizations, consistent with Section 401.[58] The FRB also separately issued its own notice of proposed rulemaking that apply the same revised framework for the prudential standards imposed by the FRB. The public comment period for these rulemakings closed on January 22, 2019.

  In May 2019, the agencies issued a proposal to determine the applicability of capital and liquidity requirements for foreign banking organizations based on a risk-based framework analogous to the framework proposed for domestic banking organizations. The FRB also issued a similar proposal applying the framework for the FRB's prudential standards.

[56] *See* OCC, FRB, FDIC "Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures," 83 Fed. Reg. 48,990 (Sept. 28, 2018) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2018-09-28/pdf/2018-20875.pdf.
[57] *See* OCC, FRB, FDIC "Regulatory Capital Rules: Treatment of Land Development Loans for the Definition of High Volatility Commercial Real Estate Exposure," 84 Fed. Reg. 35,344 (July 23, 2019) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2019-07-23/pdf/2019-15332.pdf.
[58] *See* supra note 18.

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In addition, the FRB and FDIC issued a proposal to tailor resolution planning requirements for large U.S. and foreign banking organizations, also consistent with Section 401.[59] The public comment period for these proposals closed on June 21, 2019.

Section 401 raised the $50 billion minimum asset threshold for general application of enhanced prudential standards under Section 165 of the Dodd-Frank Act to $250 billion, and provides the FRB with discretion to apply standards to bank holding companies with total consolidated assets of $100 billion or more, but less than $250 billion.[60] The threshold increase occurs in two stages. Immediately on the date of enactment, bank holding companies with total consolidated assets of less than $100 billion were no longer subject to Section 165, with the exception of the section's risk committee requirement. Eighteen months after the date of S. 2155's enactment, the threshold is raised to $250 billion, with authority of the FRB to apply any enhanced prudential standard to bank holding companies with total consolidated assets equal to or greater than $100 billion and less than $250 billion based on certain factors.

- **Section 402 - Supplementary leverage ratio for custodial banks**
  In April 2019, the federal banking regulators issued a notice of proposed rulemaking that amends the supplementary leverage ratio of the regulatory capital rule to exclude certain funds of banking organizations deposited with central banks if the banking organization is predominantly engaged in custody, safekeeping, and asset-servicing activities, consistent with Section 402.[61] The public comment period for this rulemaking closed on July 1, 2019.

The following interagency rulemakings required by the Dodd-Frank Act have not yet been finalized:

- Section 205(h) – Orderly liquidation of Covered Brokers and Dealers
- Section 213(d) – Industry-wide Ban on Certain Activities by Senior Executives and Directors
- Section 616(d) – Source of Strength Requirement for Bank Holding Companies, Savings and Loan Holding Companies, and other Companies that Control IDIs
- Section 956 – Incentive-Based Compensation
- Section 1025(e)(4)(E) – Retaliation Against IDI or Other Covered Person that Appeals a Conflicting Supervisory Determination
- Section 1473(q) – Automated Valuation Models

[59] *See* supra note 19.
[60] S. 2155 also provides that any bank holding company, regardless of size, that has been identified as a global systemically important bank holding company (G-SIB) under the FRB's G-SIB surcharge rule shall be considered a bank holding company with $250 billion or more in total consolidated assets for purposes of the application of standards under section 165 and certain other provisions.
[61] *See* supra note 27.

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The agencies continue to work to finalize the remaining statutory requirements. For example, the final rule regarding appraisals that implements Section 103 of S. 2155, also implemented Section 1473(e) of the Dodd-Frank Act, which had not been previously implemented.

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

As regulators, you have indicated that relieving the burdens on banks, especially those placed on banks through the Bank Secrecy Act is a highest priority. While compliance is expensive, the trade off in lowering BSA compliance standards is potentially weakening safeguards to combat terrorists and criminal activity where their financing flows through the U.S. financial system.

26) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, banks and credit unions often complain they do not receive meaningful feedback on whether their efforts on BSA/AML are helpful to law enforcement. What steps is your agency taking to provide better feedback and guidance to community banks and credit unions?

Response: The FDIC understands and agrees with the importance of regular communication with community banks. At all levels of the FDIC, there is a regular and deliberate practice of communicating with community banks. FDIC staff participate in multiple Anti-Money Laundering (AML) conferences with banks and other regulators, and we also host meetings with bankers that give us the opportunity to talk about their Bank Secrecy Act (BSA)/AML concerns.

In addition, the FDIC's Advisory Committee on Community Banks provides advice and recommendations on a broad range of policy issues that have particular impact on community banks throughout the United States and the local communities they serve, with a focus on rural areas. On March 28, 2019, representatives of the Financial Crimes Enforcement Network (FinCEN) made a presentation to the committee on the use of bank filings under the BSA. These meetings are webcast and available on FDIC's website.[62]

To further highlight our strong commitment, the leaders of the federal banking agencies, the U.S. Department of the Treasury Under Secretary for Terrorism and Financial Intelligence, and FinCEN have formed a group to improve the efficiency and effectiveness of BSA/AML regulations, supervision, and examinations. The group meets monthly and has convened a staff-level working group to focus on specific initiatives in this area.

The group's work so far resulted in the issuance of three joint statements. In October 2018, we issued a joint statement addressing banks sharing resources to manage their BSA/AML obligations more efficiently and effectively, something particularly important for community-focused institutions that have more limited resources.[63] In December 2018, we issued a joint

[62] Available at https://www.fdic.gov/communitybanking/.
[63] FRB, FDIC, FinCEN, NCUA, OCC "Interagency Statement on Sharing Bank Secrecy Act Resources," (Oct. 2018), available at https://www.fdic.gov/news/news/press/2018/pr18068a.pdf.

statement to encourage innovative industry approaches to BSA/AML compliance.[64] In July, we issued a joint statement that describes our risk-focused approach to BSA examinations.[65] Additionally, there is ongoing work in the areas of BSA enforcement, model review, and the FFIEC BSA/AML Examination Manual update.

The FDIC's public website (www.fdic.gov) provides many resources for bankers on BSA/AML topics: a BSA examination program overview, technical assistance videos, supervisory documents, and other reference materials. Additionally, as part of our Community Banking Initiative, the FDIC offers a series of educational videos designed to provide useful information to bank directors, officers, and employees on areas of supervisory focus and regulatory changes, including BSA/AML compliance. In December 2018, the FDIC released an updated technical assistance video on the BSA/AML requirements and the Office of Foreign Assets Control (OFAC) sanctions programs. Among other topics, the video describes the role of FinCEN and discusses the FDIC's supervisory and enforcement approach to BSA compliance.

The FDIC is also a member of the Bank Secrecy Act Advisory Group (BSAAG), which is chaired by FinCEN. The BSAAG provides an opportunity for regulators, law enforcement, and the private sector to have shared input on multiple BSA/AML regulatory, supervisory, and implementation issues. The BSAAG holds two meetings each year, and has committees that meet throughout the year to consider money-laundering risk, regulatory obligations, and industry feedback.

27) What steps is your agency taking to ensure law enforcement has all the information it needs to combat terrorism and illicit activity?

Response: As part of our BSA/AML compliance program, the FDIC assesses whether institutions have established the appropriate policies, procedures, and processes (tailored to their money laundering/terrorist financing risk) to identify and report suspicious activity and currency transactions greater than $10,000. We also assess whether the institutions provide sufficient detail in suspicious activity reports (SARs) to make the SARs useful for law enforcement investigations of the suspicious transactions that are reported.

If an examiner identifies unreported activity for which a SAR should be filed, the FDIC would either: (1) request that the institution file a SAR or (2) file a SAR on behalf of the institution.

Additionally, examiners assess institutions' policies, procedures, and processes associated with FinCEN's information-sharing regulations that enable federal, state, local, and foreign (European Union) law enforcement agencies, through FinCEN, to reach out to more than 16,000 financial institutions to locate accounts and transactions of persons that may be involved in terrorism or money laundering. FinCEN receives requests from law enforcement and upon review, sends

[64] FDIC, FRB, NCUA, OCC, FinCEN "Interagency Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing," (Dec. 2018), available at https://www.fdic.gov/news/news/financial/2018/fil18079.pdf.
[65] FDIC, FRB, NCUA, OCC, FinCEN "Interagency Statement on Risk-Focused Bank Secrecy Act/Anti-Money Laundering Supervision," (July 2019), available at https://www.fdic.gov/news/news/financial/2019/fil19043.pdf.

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notifications to designated contacts within financial institutions across the country once every two weeks informing them that new information has been made available via a secure Internet website. The requests contain subject and business names, addresses, and as much identifying data as possible to assist the financial institutions as they search their records. The financial institutions must query their records for data matches, including accounts maintained by the named subject during the preceding 12 months and transactions conducted within the last six months.

Financial Stability and Lessons from the Financial Crisis

28) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, earlier this week, former Fed Chairs Bernanke and Yellen, along with former Treasury Secretaries Geithner and Lew, wrote a letter to Chairman Powell and Secretary Mnuchin about a proposal by FSOC to make it much harder to designate a future AIG that poses a systemic risk to the financial system.[66] The former officials wrote, "Though framed as procedural changes, these amendments amount to a substantial weakening of the post-crisis reforms. These changes would make it impossible to prevent the buildup of risk in financial institutions whose failure would threaten the stability of the system as a whole." Given these significant concerns, will FSOC reconsider its proposed guidance that would, in the words of these officials, "neuter the designation authority"?

Response: FSOC published its Notice of Proposed Interpretive Guidance and requested public comment concerning FSOC's authority to require supervision and regulation of certain non-bank financial companies pursuant to Section 113 of the Dodd-Frank Act.[67] The letter you cite was submitted during the comment period along with the views of other commenters. Consistent with the Administrative Procedures Act, FSOC is carefully evaluating all of the comments received, including the comments from former Federal Reserve Chairs Ben Bernanke and Janet Yellen and former Treasury Secretaries Timothy Geithner and Jack Lew. If FSOC votes to publish a final interpretive guidance, those comments will be addressed at that time.

29) Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, given that FSOC is taking a so-called "activities-based approach" to supervising for systemic risk, is that any different than the weak financial stability oversight we had before the financial crisis, especially since FSOC has no authority to mandate new regulations to address systemic concerns identified through an activities-based approach?

Response: FSOC's proposed interpretive guidance offers an improved approach to addressing potential risks to U.S. financial stability before resorting to firm-specific designation. Under the

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[66] *See* https://www.nytimes.com/2019/05/13/us/politics/financial-regulation-trump-administration.html and https://int.nyt.com/data/documenthelper/887-bernanke-geithner-lew-yellen-letter/a22621b202dfcb0fe06e/optimized/full.pdf.
[67] *See* FSOC, "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies," 84 Fed. Reg. 9,028 (Mar. 13, 2019) (to be codified at 12 C.F.R. pt. 1310), available at https://www.govinfo.gov/content/pkg/FR-2019-03-13/pdf/2019-04488.pdf.

proposed approach, FSOC would first identify and attempt to address activities that present systemic risk, which may be occurring by many firms and across sectors. If FSOC, working with the relevant financial regulators, is unable to adequately address a potential risk, and if FSOC determines that a non-bank financial company could pose a threat to U.S. financial stability, FSOC retains the authority to designate such a firm under Section 113 of the Dodd-Frank Act, in which case the company would be supervised by the FRB and enhanced prudential standards would apply to the company. FSOC has determined that evaluating activities, working with relevant primary regulators, and considering the use of activities-focused tools available to FSOC and its members individually is more effective than a limited series of microprudential, entity-specific designations. However, as FSOC's proposed interpretative guidance makes clear, the ability to designate a firm or set of firms remains available when warranted.

Additionally, FSOC takes various other steps to provide oversight of financial stability. One of FSOC's statutorily established duties is to monitor the financial services marketplace. To do so, FSOC has established a committee structure, with committee members drawn from its member agencies. Several of its committees are particularly relevant to monitoring risk issues, including risks related to leveraged lending, such as the FSOC Deputies Committee and the Systemic Risk Committee. The purpose of the Systemic Risk Committee is to support FSOC in identifying risks to, and in responding to emerging threats to, the stability of the U.S. financial system, including by monitoring and analyzing financial markets, the financial system, and issues related to financial stability, such as leveraged lending. The committee takes direction from and reports to the Deputies Committee, which also considers such matters. The work of FSOC and all of its committees is reflected in FSOC's Annual Report. The activities-based approach leverages this work and committee structure to feed into recommendations for market-wide or industry-wide regulatory changes.

Furthermore, FSOC and its member agencies have taken many steps since the financial crisis that have stabilized and strengthened the financial system. These efforts have led to, for example, strengthened capital and liquidity and the development and refinement of resolution plans by the most systemically important banks, all of which are critical for financial stability.

30) Chairman McWilliams and Chairman Hood, do you believe there are any financial regulations that need to be strengthened, or areas that Dodd-Frank did not go far enough?

Response: Since arriving at the FDIC, I have undertaken a comprehensive review of the agency's regulations and policies, and we have proposed or finalized a number of changes to existing regulations and policies. All of these changes are intended to strengthen our regulatory regime and, to the extent necessary, update and modernize regulations that have not kept pace with technological and digital changes in the banking industry.

To give examples of initiatives that could increase the stringency of requirements on financial institutions, the FDIC, along with the FRB and OCC, recently issued proposed rules that would (1) impose heightened capital charges on the largest banks for holding debt that qualifies as total loss absorbing capacity (TLAC) and (2) impose heightened capital requirements on loans that

finance the development of land for residential properties. The agencies have also indicated an intent to finalize the Net Stable Funding Ratio later this year. I also recently gave a speech on the work to be done to address resolution planning for central counterparties (CCPs), where our tools are more limited than they are with respect to the largest banks.[68]

The FDIC has issued several rules under our organic statutes that strengthen the stability of our financial system and impose additional regulatory requirements on depository institutions. One example is the requirement that IDIs file resolution plans, separate from the resolution plans required of bank holding companies under the Dodd-Frank Act. Another example is the "Recordkeeping for Timely Deposit Insurance Determination" rule that requires all IDIs with more than two million in deposits to maintain complete and accurate information to allow the FDIC to make deposit insurance determinations in the event of failure.

The FDIC is also engaged in a number of other initiatives to strengthen regulations. For example, the FDIC issued an advance notice of proposed rulemaking in December seeking public comment on all aspects of the brokered deposits and interest rate restrictions regulations[69] and approved a notice of proposed rulemaking in August specifically addressing interest rate restrictions.[70] The brokered deposits regulation has not been updated since the 1990s, while the interest rate restrictions are an area in urgent need of adjustment, given changes in interest rates over the past several years.

31) Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, has the Financial Stability Oversight Council (FSOC) helped to eliminate regulatory gaps in our financial regulatory system? Should Congress consider legislation to strengthen FSOC's tools to ensure it is well equipped to head off a future crisis?

Response: FSOC monitors regulatory gaps and developments that could contribute to, or mitigate risk to, the stability of the U.S. financial system. In addition, it serves as a forum for members to discuss the regulatory and other issues facing their agencies and the industry. When warranted, FSOC may make recommendations to member agencies where regulatory authority already exists or to Congress when additional authority is needed. FSOC delivers an annual report to Congress which includes recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets; to promote market discipline; and to maintain investor confidence.[71]

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[68] https://www.fdic.gov/news/news/speeches/spjul0119.html
[69] *See* FDIC "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions," 84 Fed. Reg. 2,366 (Feb. 2, 2019) (to be codified in 12 C.F.R. pt. 337) available at https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.
[70] *See* FDIC "Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized" 84 Fed. Reg. 46470 (September 4, 2019) (to be codified at 12 C.F.R. pt. 337) available at https://www.fdic.gov/news/board/2019/2019-08-20-notice-dis-b-fr.pdf.
[71] FSOC's current recommendations can be found in its most recent Annual Report at: https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf.

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Leveraged Lending

The Federal Reserve recently issued its Financial Stability Report noting that, "borrowing by businesses is historically high relative to gross domestic product (GDP), with the most rapid increases in debt concentrated among the riskiest firms amid signs of deteriorating credit standards."[72] Additionally, the ratio of debt to assets among publicly traded, nonfinancial firms is near a 20-year high, and the share of new loans going to the most indebted companies is near peaks reached in 2014 and just before the 2007 to 2009 financial crisis. Acknowledging this emerging risk, on February 25, 2019, the Federal Reserve, OCC and FDIC jointly responded to a letter from Sen. Warren, stating, "The leveraged loan market continues to warrant attention." They described that "while underwriting and risk management practices generally have improved in agency-supervised institutions, more recently Agency examiners have observed in some transactions fewer and less stringent protective covenants, more liberal repayment terms, and incremental debt provisions that allow for increased debt that may inhibit deleveraging capacity and dilute repayment to senior secured creditors."[73]

32) Chairman McWilliams, is leveraged lending an appropriate issue for FSOC and the Office of Financial Research to examine?

Response: Leveraged lending has been a frequent topic of discussion at FSOC since I became a member last year. FSOC principals received briefings on issues related to nonfinancial corporate credit at FSOC meetings on March 6 and May 30 of this year. Additionally, the issue has been discussed in several past FSOC Annual Reports. For more information, please see:

- **An update on nonfinancial corporate credit presented at the March 6, 2019, FSOC meeting in Executive Session** March 6, 2019, Executive Session: (https://home.treasury.gov/system/files/261/March062019_minutes.pdf): Update on non-financial corporate credit. Staff of the Office of Financial Research (OFR) and FRB addressed: (1) four key vulnerabilities that have emerged due to the low-interest rate environment and the long credit cycle and (2) the increasing importance of non-bank lenders, particularly in leveraged loans, and exposures of banks to corporate credit markets. (Discussion begins on page 3.)

- **An update on nonfinancial corporate credit and leveraged lending presented at the May 30, 2019, FSOC meeting** May 30, 2019: (https://home.treasury.gov/system/files/261/May302019_readout.pdf): Update from Craig Phillips, Counselor to the Treasury Secretary, regarding U.S. non-financial corporate credit and leveraged lending. Counselor Phillips described recent market

[72] https://www.federalreserve.gov/publications/files/financial-stability-report-201905.pdf
[73] https://www.forbes.com/sites/mayrarodriguezvalladares/2019/05/07/u-s-bank-regulators-acknowledge-senator-warrens-concerns-about-rapidly-growing-leverage-lending-markets/#180ba94f1533

developments and highlighted the ongoing collaboration among financial regulators on this topic.

FSOC *Annual Reports* (from 2011 to 2018)

- The 2011 Annual Report (https://www.treasury.gov/initiatives/fsoc/Documents/FSOCAR2011.pdf) noted that loosened underwriting standards may have led to heightened risks in leveraged loans. (*See* pages 12 and 105 (Section 5.4.3 – Loans).

- The 2012 Annual Report (https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2012%20Annual%20Report.pdf) recommended continued monitoring and discussed the banking agencies' issuing for comment proposed leveraged lending guidance.

- The 2013 Annual Report (https://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf) noted that continued yield-seeking was increasing leveraged lending, and that on March 21, 2013, the banking agencies adopted, after notice and comment, updated leveraged lending guidance for the banking agencies' supervised entities. (*See* page 114.)

- The 2014 Annual Report (https://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202014%20Annual%20Report.pdf) noted that a sharp increase in interest rates could increase the risk of default of leveraged loans. In addition, a focused review of leveraged loans during the banking agencies' Shared National Credit (SNC) Review[74] for 2013 found material widespread weaknesses in underwriting practices, including excessive leverage, inability to amortize debt over a reasonable period, and lack of meaningful financial covenants. (*See* page 40.)

- The 2015 Annual Report (https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2015%20FSOC%20Annual%20Report.pdf) reported that FSOC had considered issues related to leveraged lending, finding that it warranted continued monitoring as the 2014 SNC review identified serious deficiencies in underwriting standards and risk management practices. (*See* pages 3 and 10.)

- The 2016 Annual Report (https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf) noted that the 2015

[74] The *SNC Program Review Report* is issued jointly by FRB, FDIC, and OCC each year, and discusses the results of the SNC program, which is an interagency review and assessment of risk in the largest and most complex credits shared by multiple regulated financial institutions. The SNC Program is governed by an interagency agreement among the FRB, FDIC, and OCC.

SNC review indicated liberal underwriting standards in leveraged lending. (*See* page 34.)

- o The 2017 Annual Report (https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC_2017_Annual_Report.pdf) discussed leveraged lending in Section 4.3 (Corporate Credit), Section 4.13.5 (Alternative Funds), and Section 4.11 (Bank Holding Companies and Depository Institutions).

- o The 2018 Annual Report (https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf) continued the discussion of leveraged lending issues.

- **Shared National Credit (SNC) Program Review Report.** Leveraged lending currently represents a significant portion of the credits reviewed through the SNC Program.

  - o The *2018 SNC Program Review Report* is available at https://www.fdic.gov/news/news/press/2019/pr19004.html.

  - o The *2017 SNC Program Review Report* is available at https://www.fdic.gov/news/news/press/2017/pr17058.html.

  - o Until 2016, the SNC Review was performed annually. Currently, the agencies conduct SNC reviews in the first and third calendar quarters with some banks receiving two reviews and others receiving a single review each year. The agencies issue a single statement annually that includes combined findings from the previous 12 months.

- **Treasury's "Study of the Effects of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth (March 2016)"** (available at https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/Final%20Section%20123%20Report%20March%2025%202016.pdf). Although not specifically about leveraged lending, this study contains a general discussion of the effects of leverage. The study was issued pursuant to Section 123 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and updates the previous study issued in 2011.

One of FSOC's statutorily established duties is to monitor the financial services marketplace.[75] To do so, FSOC has established a committee structure, with committee members drawn from its member agencies.[76] Several of its committees are particularly relevant to monitoring risk issues, including risks relating to leveraged lending, such as the FSOC Deputies Committee and the

[75] See 12 U.S.C. § 5322(a)(2)(C) (2019).
[76] *See* Financial Stability Oversight Council Bylaws, *Rules of Organization of the Financial Stability Oversight Council* §XXX.7 (adopted October 1, 2010; amended and restated on April 24, 2018), available at https://www.treasury.gov/initiatives/Documents/FSOCbylaws.pdf.

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Systemic Risk Committee. The purpose of the Systemic Risk Committee is to support the FSOC in identifying risks to, and in responding to emerging threats to, the stability of the U.S. financial system, including by monitoring and analyzing financial markets, the financial system and issues related to financial stability, such as issues like leveraged lending.[77] That Committee takes direction from and reports to the Deputies Committee which also considers such matters. The work of the FSOC and all of its committees is reflected in the FSOC's Annual Report.

FSOC has been concerned more generally about the overall risks of leverage. Although not specifically about leveraged lending, the "Study of the Effects of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth," dated March 2016, contains a general discussion of leverage.[78] This study, issued pursuant to Section 123 of the Dodd-Frank Act, updates a previous study issued in 2011.

33) What are the potential tools bank regulators, FSOC and OFR has to mitigate any risks to the U.S. economy or financial stability that may arise from leveraged lending?

Response: The federal banking regulators have regulatory, supervisory, and examination tools to mitigate risks that may arise from the leveraged lending activities by supervised entities. For instance, the *Interagency Guidelines Establishing Standards for Safety and Soundness* (Appendix A to Part 364 of the FDIC's Rules and Regulations) contain operational and managerial standards for asset quality, credit underwriting, and loan documentation that are directly applicable.[79] Further, to assist financial institutions in meeting the safety and soundness standards in Part 364, the agencies updated and issued the "Interagency Guidance on Leveraged Lending" in 2013.[80] While the guidance is non-binding, it outlines for agency-supervised institutions high-level principles related to safe and sound leveraged lending activities. The guidance is designed to assist financial institutions that engage in leveraged lending activities do so in a safe and sound manner.

One important supervisory tool to assess leveraged lending issues is the Shared National Credit (SNC) Program, an interagency review and assessment of risk in the largest and most complex credits shared by multiple regulated financial institutions. Each year, the participating agencies issue a joint Review Report that discusses the results of the SNC review.

In addition to the federal banking regulators' supervisory authorities, FSOC is charged with identifying risks and responding to emerging threats to financial stability, and the Office of Financial Research (OFR) provides data and analysis. As part of this responsibility, FSOC

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[77] *See* Financial Stability Oversight Council, *Charter of the Systemic Risk Committee of the Financial Stability Oversight Council*, available at https://www.treasury.gov/initiatives/fsoc/governance-documents/Documents/The%20Council%27s%20Committee%20Charters.pdf.
[78] Available at https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/Final%20Section%20123%20Report%20March%2025%202016.pdf
[79] Available at https://www.fdic.gov/regulations/laws/rules/2000-8630.html#fdic2000appendixatopart364.
[80] *See* OCC, FRB, FDIC, "Interagency Guidance on Leveraged Lending," 78 Fed. Reg. 56 (Mar. 22, 2013), available at https://www.federalregister.gov/documents/2013/03/22/2013-06567/interagency-guidance-on-leveraged-lending.

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facilitates regulatory coordination, information sharing, and information collection, and works with regulators to identify and address potential risks to financial stability, recommending stricter standards and designating non-bank financial institutions for supervision by the FRB.

In addition to the SNC review, the FDIC examines the risk presented to regulated institutions from its various credit activities, including leveraged lending. In this regard, the FDIC ensures that banks are conducting the activity in a safe and sound manner and in accordance with applicable laws and regulations, including the *Interagency Guidelines Establishing Standards for Safety and Soundness*. Among other requirements set forth in the interagency standards that are applicable to credit activities, including leveraged lending, institutions must:

- Have appropriate internal controls;
- Have effective risk assessment;
- Have loan documentation practices that ensure the loan is legally enforceable and that assess the ability of the borrower to repay the indebtedness in a timely manner;
- Demonstrate appropriate administration and monitoring of a loan;
- Establish and maintain prudent credit underwriting practices, including analysis of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed; and
- Establish and maintain a system to identify problem assets and prevent deterioration in those assets, with independent, ongoing credit review and appropriate communication to management and to the board of directors.

If the FDIC determines there are deficiencies in internal controls, risk assessments, or loan underwriting, documentation, or monitoring at an institution, it will take appropriate action. Depending on the severity of the deficiency, the action may range from supervisory recommendations in an examination report, to informal or formal enforcement action. Informal enforcement actions might include a Memorandum of Understanding with the institution. Formal enforcement actions can include requiring a corrective plan under Section 39[81] of the FDI Act, cease and desist orders under Section 8[82] of the FDI Act, civil money penalties, and other actions. In addition, individual credits may be criticized or adversely classified.

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[81] *See* 12 U.S.C. § 1831p–1(e). Available at https://www.govinfo.gov/content/pkg/USCODE-2006-title12/pdf/USCODE-2006-title12-chap16-sec1831p-1.pdf.
[82] *See* 12 U.S.C. § 1818(a). Available at https://www.govinfo.gov/content/pkg/USCODE-2010-title12/pdf/USCODE-2010-title12-chap16-sec1818.pdf.

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Representative Bill Foster:

Industrial Loan Company (ILC) Charters

Chairman McWilliams, some fintech companies have explored getting an Industrial Loan Company (ILC) charter, which has not been granted by the FDIC in more than a decade and was the subject of a Dodd-Frank moratorium until 2013. You have said that the threshold for approving an application would not be low, and that you would carefully examine the risks involved.

1) a. Do we have the statutory and regulatory safeguards necessary to ensure that such industrial loan companies do not leave gaps in safety and soundness oversight? What characteristics are you examining to ensure that FDIC-insured ILCs wouldn't pose a risk to the broader financial system?

Response: Congress provided the FDIC with the necessary statutory and regulatory authorities to effectively supervise insured ILCs.[83] ILCs are subject to the same federal statutes and regulations that apply to all state non-member institutions, including those related to consumer protection, community reinvestment, affiliate transactions, and safety and soundness.

The safety and soundness supervisory program evaluates capital, asset quality, management, earnings, liquidity, and sensitivity to market risk, as well as information technology, anti-money laundering, and other operational elements of the institution. The FDIC's approach to ILC supervision focuses on the ILC itself and not the corporate parent. This approach was tested during the last financial crisis. Despite the failure and bankruptcy of a number of commercial and financial parents of ILCs, no ILC failed because of failure of a parent company, and only two ILCs failed during the financial crisis: Security Savings Bank in Henderson, NV and Advanta Bank Corp in Draper, Utah (Advanta).

b. The line between tech companies and financial companies is an increasingly blurry one. Commercial companies who get an ILC charter do not have to divest any nonbanking-related commercial activities. Is there anything preventing large companies such as Google or Amazon, from getting a charter?

Response: Generally, a commercial firm may own or control a financial institution that is exempt from the definition of "bank" in the Bank Holding Company Act, as is the case with ILCs, if the commercial firm obtains a charter from the chartering authority and deposit insurance from the FDIC. The FDIC will assess such an application for deposit insurance in light of a set of statutory factors, including among others, financial and managerial resources, future prospects, the convenience and needs of the community to be served, the risks to the financial system, and the effectiveness of the firm's anti-money laundering program. Deposit

[83] *See* 12 U.S.C. § 1820. Available at https://www.govinfo.gov/content/pkg/USCODE-2011-title12/pdf/USCODE-2011-title12-chap16-sec1820.pdf.

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insurance applications for new ILCs are acted on by the FDIC Board, not under delegated authority.

c. Do you think an ILC charter is appropriate for fintech companies (as opposed to purely commercial companies)? Or would traditional bank charters be more appropriate?

Response: Determinations regarding the charter type for a proposed institution are the decisions of the organizing group and may reflect consideration of multiple factors, including the proposed business strategy and model, the customer markets and geographic reach of the institution's operations, and the organizational structure within which the institution would operate.

Inter-affiliate Swaps

Vice Chairman Quarles, Chairman McWilliams, and Comptroller Otting, I wanted to ask you about your approach to initial margin on inter-affiliate swaps:

2) a. The Fed, FDIC, and OCC require this margin on inter-affiliate financial transactions of U.S. banks, and it is estimated that nearly $40 billion is held to comply with this requirement. This seems to be inconsistent with international regulators that do not require inter-affiliate initial margin. Do you agree with this? Why or why not?

Response: I agree that most international regulators do not have specific inter-affiliate initial margin requirements included in their margin regulations. On September 17, the FDIC approved a proposed rule that would exempt inter-affiliate transactions from initial margin requirements.[84]

b. Further, this requirement seems to be inconsistent with the CFTC's approach to non-bank swaps dealers. In fact, in adopting the final rule on margin for uncleared swaps in December 2015, former CFTC Chairman Timothy Massad noted that "Inter-affiliate transactions are not outward-facing and thus do not increase the overall risk exposure of the consolidated enterprise to third parties. Instead, they are typically a means for the consolidated enterprise to centrally manage risk related to the activities of multiple subsidiaries. Imposing the same third-party transaction standards on these internal activities of consolidated entities is likely to significantly increase costs to end-users without any commensurate benefit." Do you agree with this rationale? Why or why not?

Response: While Section 23B of the Federal Reserve Act has generally required insured depository institutions to engage in transactions with affiliates on market terms and conditions, I appreciate the costs associated with requiring initial margin for inter-affiliate transactions. As mentioned above, on September 17, the FDIC approved a proposed rule that would alter this requirement.[85]

[84] *See* OCC, FRB, FDIC, FCA, and FHA, "Margin and Capital Requirements for Covered Swap Entities," awaiting Federal Register publication (proposed September 17, 2019) (to be codified at 12 C.F.R. pt. 349), available at https://www.fdic.gov/news/board/2019/2019-09-17-notice-dis-b-fr.pdf.
[85] *Id.*

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c. Last year, Vice Chairman Quarles testified in front of the House Financial Services Committee that this should be a priority of the Federal Reserve. Do you all agree it is a priority, and is there a timeline to make this requirement consistent with regulators around the world?

Response: Yes. As mentioned above, the FDIC has approved a proposed rule to exempt inter-affiliate transactions from initial margin requirements.[86]

[86] *Id.*

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Representative Jesús "Chuy" García:

1) The FDIC has a statutory mandate to protect the Deposit Insurance Fund. The agency must be a careful steward in administering taxpayers' deposit-insurance system. The first line of defense standing in front of the DIF is bank capital. When banks have the capacity to absorb their own losses, bank failures are limited and the DIF is shielded from losses. A reduction in bank capital requirements, however, increases the likelihood of bank failures and puts the DIF at risk. The recent enhanced supplementary leverage ratio proposal would reduce the capital levels at insured depository institutions of G-SIBs by $121 billion, or 20%. Does the FDIC support this rule? Would the rule increase the likelihood of GSIB insured depository failures? How is the rule's impact consistent with the FDIC's mandate to protect the Deposit Insurance Fund?

Response: The enhanced Supplementary Leverage Ratio (eSLR) is an area that the federal banking regulators have been reviewing. Section 402 of EGRRCPA requires the three agencies to amend the supplementary leverage ratio for custodial banking organizations to address the treatment of certain deposits at central banks. The agencies issued an interagency proposal to address Section 402 in March 2019.[87] The FDIC will continue to monitor whether additional changes to capital and leverage rules are warranted.

[87] *See* OCC, FRB, FDIC "Regulatory Capital Rule: Revisions to the Supplementary Leverage Ratio To Exclude Certain Central Bank Deposits of Banking Organizations Predominantly Engaged in Custody, Safekeeping and Asset Servicing Activities," 83 Fed. Reg. 18,175 (proposed Mar. 29, 2019) (to be codified at 12 C.F.R. pt. 324), available at https://www.govinfo.gov/content/pkg/FR-2019-04-30/pdf/2019-08448.pdf.

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Representative Bill Posey:

Bank Capital Requirements

1) For all the panelists: Some economists believe the emphasis on capital requirements conditioned on perceptions from the financial crisis have unduly restricted capital market expansion and really don't provide a great deal of protection against a liquidity-driven downward spiral in asset prices. Capital — even if insufficient — didn't really go very far in the crisis. The commercial banking system works because we have a clearing system of short-term credit to meet liquidity constraints by banks borrowing overnight when they are short and lending when they are long. Do we need to think about policies or measures to better assure the ability of securities dealers and investment bankers to rollover their credit and keep the asset markets stable and avoid the kinds of liquidity instabilities we saw in the crisis?

Response: After the financial crisis of 2008 and 2009, the FDIC, Federal Reserve Board, and Office of the Comptroller Currency ("the agencies") sought to improve the resiliency of the banking system and enhance safeguards for the Deposit Insurance Fund (DIF). To address liquidity instabilities, the agencies imposed a liquidity coverage ratio that required certain banks to maintain adequate levels of high-quality liquid assets to ensure their ability to meet short-term obligations over a 30-day period of stress. The goal is to lower the likelihood of funding disruption and liquidity stress during an adverse economic or market environment.

While strong capital and liquidity requirements at our largest banks are crucial, it is prudent to continually monitor the impact that regulations have on markets. The agencies are currently in the process of tailoring the application of capital and liquidity rules based on the risk profile of banks in the United States, and will continue to monitor whether further adjustments are warranted.

2) For all the panelists: Are current bank capital requirements based on Basel and other research really providing risk reduction benefits that exceed their prospective costs in terms of restricting credit and capital markets?

Response: Strengthening capital requirements at our nation's largest, most systemically important banks was an essential post-crisis response as strongly capitalized banks are better able to withstand financial and economic headwinds.

At the same time, it is essential that the agencies periodically evaluate regulations to ensure they remain efficient and effective. The agencies recently issued two proposed rules that would more finely tailor the application of regulatory capital and liquidity requirements based on a banking organization's size, risk profile, and systemic footprint. Our largest, most systemically important banks would continue to be subject to the most rigorous standards, while smaller, less systemically important banks would be subject to standards tailored to their risk profile. My

hope is that these proposals can be finalized in the near term to provide needed tailoring to our regulatory capital and liquidity frameworks in a way that better recognizes the risk profile of affected institutions.

Congressional Oversight

3) <u>For all the panelists:</u> Legislation under consideration in this hearing would expand oversight by making additional hearings mandatory for the prudential regulators. Shouldn't we hold these hearings when events prompt them rather than blindly require them at recurring intervals? Can we rely on a process of written reports with appropriate issues focus from you and our own surveillance of the financial system to alert us to the need for oversight hearings? Do you have any specific ideas in this regard?

Response: As a former counsel for the Senate Banking Committee and the Senate Small Business Committee, I recognize and appreciate the role and significance of congressional oversight. However, I defer to Congress as to the appropriate manner, subject matter, witnesses, and frequency for congressional hearings.

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Representative Ben McAdams:

Cybersecurity

1) During the hearing, most witnesses testified regarding the risk cyber threats and attacks could pose to the financial system broadly, and individual financial institutions specifically. Will you please explain the extent prudential regulators coordinate with other sectors of the Federal government, including the national security community, to address and respond to growing cyber risks?

Response: The FDIC routinely coordinates with the U.S. Department of the Treasury, which serves as the sector-specific lead, as well as with other financial services regulators and U.S. government agencies, to maintain situational awareness of the current and emerging cyber threats to FDIC-insured depository institutions. The FDIC also routinely participates in various national security-related forums, and liaises with national security agencies monitoring threats to U.S. economic security and critical infrastructure.

The FDIC is also a member of the Federal Financial Institutions Examination Council (FFIEC) which was established in 1979 by the Financial Institution Regulatory and Interest Rate Control Act of 1978 (FIRA). Through the FFIEC, the federal banking regulators created the Cybersecurity Assessment Tool to assist financial institutions in identifying their risks and determine their cybersecurity preparedness. Through the Cybersecurity and Critical Infrastructure Working Group, the federal banking regulators routinely discuss cybersecurity matters and industry preparedness.[88]

2) Additionally, please explain the extent your agencies coordinate with the financial sector (and other private and nonprofit entities) to address and respond to growing cyber risks?

Response: The FDIC actively participates in the Financial and Banking Information Infrastructure Committee (FBIIC), which serves as the financial services sector's state and federal government coordination council. The FBIIC meets three times a year with the Financial Services Sector Coordinating Council (FSSCC), the private sector's coordinating council, under the auspices of the Critical Infrastructure Partnership Advisory Council (CIPAC). These joint meetings provide a forum for the public and private sectors to share information on initiatives of common interest. The FDIC has also engaged the private sector on cyber-related issues through various organizations and forums including the Financial Services Information Sharing and Analysis Center, Financial Systemic Analysis and Resilience Center, and the FDIC's Community Bank Advisory Council.

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[88] Additional information on the FFIEC's Cybersecurity efforts is available at: https://www.ffiec.gov/cybersecurity.htm.

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3) Do you believe the current levels of coordination are sufficient or could they be enhanced in any specific way?

Response: The financial services sector has a mature and productive public-private partnership, but there is always room for improvement. For example, there could be better coordination in identifying and prioritizing the risks to the financial services sector. Also, vulnerability, threat, and incident information sharing through existing mechanisms, such as the Financial Services Information Sharing and Analysis Center and the Department of Homeland Security's Homeland Security Information Network, could be leveraged to provide the public and private sector more information for prioritizing resource allocation.

4) Do you believe you have the statutory, regulatory, and supervisory tools necessary to ensure that cyber risks do not pose a threat to the financial system broadly, or to individual financial institutions specifically?

Response: Section 10 of the FDI Act[89] establishes the FDIC's authority over depository institutions that it supervises. The focus of FDIC examinations relative to cyber risk is on the safe and sound operation of the institution's information technology systems, and the institution's compliance with the privacy-related federal consumer protection laws and regulation, particularly the Gramm-Leach-Bliley Act of 1999.

The FDIC has promulgated regulations in relation to this authority. Part 364 of the FDIC Rules and Regulations[90] addresses Standards for Safety and Soundness, and Part 337 addresses Unsafe and Unsound Banking Practices.[91] Specifically, in relation to cyber risks, Part 364 appendix B is titled "Interagency Guidelines Establishing Information Security Standards."[92]

The FDIC's Division of Risk Management Supervision examines the information technology systems of supervised financial institutions pursuant to the FDIC's authority to review the operations of supervised financial institutions. The Division of Depositor and Consumer Protection examines supervised financial institutions for compliance with privacy-related consumer protection laws and regulations. The FDIC, along with other Federal Financial Institutions Examination Council members, has issued multiple joint statements on cyber risks and controls, and provided information individual financial institutions may use to mitigate cyber risks.

The Bank Service Company Act also gives FDIC authority to examine the provision of bank services to supervised institutions by third parties. Subsection 7(c) of the BSCA, 12 U.S.C. §

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[89] *See* 12 U.S.C. 1820(a). Available at https://www.govinfo.gov/content/pkg/USCODE-2011-title12/pdf/USCODE-2011-title12-chap16-sec1820.pdf.

[90] *See* 12 C.F.R. § 364. Available at https://www.govinfo.gov/content/pkg/CFR-2012-title12-vol5/pdf/CFR-2012-title12-vol5-part364-appA.pdf.

[91] *See* 12 C.F.R. § 337. Available at https://www.govinfo.gov/content/pkg/CFR-2012-title12-vol5/pdf/CFR-2012-title12-vol5-part337.pdf.

[92] *See* 12 C.F.R. § 364, app. B. Available at https://www.govinfo.gov/content/pkg/CFR-2017-title12-vol5/pdf/CFR-2017-title12-vol5-part364-appB.pdf.

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1867(c) ("Subsection 7(c)")[93], vests the federal banking agencies with the authority to "regulate and examine" third-party service providers' performance of BSCA- authorized services. "Services authorized under the BSCA" includes, among other things, check and deposit sorting and posting; computing and posting interest and other credits and charges; preparing and mailing checks, statements, notices, and similar items, whether physically or electronically; and other data processing services. The federal bank regulators frequently examine these services jointly.

The FDIC addresses broader financial sector cyber risks primarily through its participation in the Financial and Banking Information Infrastructure Committee (FBIIC), and the Financial Services Sector Coordinating Council (FSSCC). This partnership is articulated in the 2015 Financial Services Sector Specific Plan (Plan)[94] written jointly by these two organizations. The Plan details a network of financial services sector companies; sector trade associations; federal government agencies; financial regulators; state, local, tribal, and territorial governments; and other government and private sector partners that collaborate on initiatives to strengthen the resilience of the financial services sector. The FBIIC, chaired by the U.S. Department of the Treasury, was chartered under the President's Working Group on Financial Markets and is comprised of 17 federal and state financial services agencies or organizations with banking, investment, and insurance subsector responsibilities. The FSSCC is comprised of 70 private sector firms representing financial trade associations, utilities, and the most critical sector firms.

Cyber threats to the financial sector continue to increase and will require increased focus from financial institutions to manage their risk. The FDIC will continue to work with supervised institutions, our regulatory partners charged with supervision of the financial services sector, the Department of Treasury, the Department of Homeland Security, the Congress, and others to identify and respond to these evolving threats.

[93] 12 U.S.C. § 1867(c). Available at https://www.govinfo.gov/content/pkg/USCODE-2010-title12/pdf/USCODE-2010-title12-chap18-sec1867.pdf.
[94] FSSCC, FBIIC "Financial Services Sector-Specific Plan 2015." (2015). Available at https://www.dhs.gov/sites/default/files/publications/nipp-ssp-financial-services-2015-508.pdf.

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Questions for The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, from Representative French Hill:

Fintech/AI Issues

The U.S. Treasury Department issued their "Nonbank Financials, FinTech and Innovation" report in July 2018 which provides a thoughtful and comprehensive report on ways to maintain and enhance America's financial technology competitive edge.

1) Based on your experience and leadership regulating financial institutions across the country, what do you believe are the top issues from the report that Congress should be prioritizing as part of our work on the FinTech and AI task force?

Response: Treasury's report put forward several issues worthy of consideration by regulators and Congress. Overall, I support maintaining and enhancing the United States' financial technology competitive edge and have implemented several initiatives at the FDIC to help identify, develop, and promote technology-driven innovations among banks (particularly among community banks, which often have limited research and development resources), while strengthening the safety and soundness of FDIC-supervised and -insured institutions.

For example, in October, I announced the formation of a dedicated office at the FDIC to focus on innovation and technology. In November, the FDIC solicited comments from the industry and the public on small-dollar lending, seeking to learn, among other things, whether technology could enhance the ability of banks to offer responsible, prudently underwritten small-dollar loan products in a sustainable and cost-effective manner, and how the FDIC could assist in supporting the necessary innovations.

Congressional input could be helpful as regulators look to applicable laws and regulations as allowing for meaningful experimentation of technology-driven innovation among banks.

Questions for the Record (Rep. Bill Foster)
FSC Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, and Accountability of Megabanks and Other Depository Institutions"
May 16, 2019

2[1]. Comptroller Otting, putting aside the current litigation, in announcing that the OCC would be accepting applications for fintech charters, the release noted that the agency expects applicants to adhere to certain "financial inclusion commitments". While the agency has given certain guidance on what would be an appropriate financial inclusion commitment, there still seems to be a lack of clarity on what such commitments would look like in practice.

a. Do you think the Community Reinvestment Act (CRA) should be amended to explicitly apply to FinTech companies?

Response: The OCC supports the application of consistent standards to entities that are similarly situated, including based on business model. The OCC stands ready to work with your staff and that of the House Financial Services Committee on issues regarding CRA applicability.

b. In your efforts to modernize the CRA with the other bank regulators, do you intend that changes made to requirements for financial institutions would be imported to FinTech companies as well?

Response: Under the CRA, the agencies have the authority to regulate insured depository institutions. For those insured depository institutions that incorporate fintech advancements as part of their business models, the CRA regulations would apply.

The OCC separately expects that any entity seeking a special purpose national bank charter (including any fintech company) will demonstrate a commitment to "financial inclusion," consistent with the OCC's mission to ensure fair treatment of customers and fair access to financial services. As discussed in the OCC's 2018 *Licensing Manual Supplement*, "Considering Charter Applications From Financial Technology Companies," the nature of this financial inclusion commitment will depend on the proposed bank's business model and the types of products, services, or activities it intends to provide.

3. Vice Chairman Quarles, Chairman McWilliams, and Comptroller Otting, I wanted to ask you about your approach to initial margin on inter-affiliate swaps:

a. The Fed, FDIC, and OCC require this margin on inter-affiliate financial transactions of U.S. banks, and it is estimated that nearly $40 billion is held to comply with this requirement. This seems to be inconsistent with that do not require inter-affiliate initial margin. Do you agree with this? Why or why not?

Response: We understand the concern and are in the process of discussing potential solutions with the Fed and FDIC.

[1] Number begins with "2" because questions not intended for the Comptroller of the Currency have been omitted.

b. Further, this requirement seems to be inconsistent with the CFTC's approach to non-bank swaps dealers. In fact, in adopting the final rule on margin for uncleared swaps in December 2015, former CFTC Chairman Timothy Massad noted that "Inter-affiliate transactions are not outward- facing and thus do not increase the overall risk exposure of the consolidated enterprise to third parties. Instead, they are typically a means for the consolidated enterprise to centrally manage risk related to the activities of multiple subsidiaries. Imposing the same third-party transaction standards on these internal activities of consolidated entities is likely to significantly increase costs to end-users without any commensurate benefit." Do you agree with this rationale? Why or why not?

Response: We agree that banks should implement risk mitigation processes that ensure the risk a bank assumes is in line with its board-approved risk appetite. Risk can be managed in a variety of manners, including inter-affiliate trades that shift risk in efforts to manage it holistically. Inter-affiliate trades promote efficiency and effectiveness by managing risk from a global perspective. It is entirely appropriate to view internal risk mitigation as separate and distinct from third-party transactions. We are considering potential amendments to the current rule.

Questions from Representative Hill - QUESTION 1- Fintech

The U.S. Treasury Department issued their "Nonbank Financials, FinTech and Innovation" report in July 2018 which provides a thoughtful and comprehensive report on ways to maintain and enhance America's financial technology competitive edge. Based on your experience and leadership regulating financial institutions across the country, what do you believe are the top issues from the report that Congress should be prioritizing as part of our work on the FinTech and AI task force?

Response: The OCC similarly found the U.S. Treasury Department report on Nonbank Financials, FinTech and Innovation to be a thorough assessment of key issues related to the emergence of new and innovative financial products and business models and their impact on the financial sector.

We are pleased to note that the OCC has addressed several areas discussed within the report, including establishing an Office of Innovation in 2016 and implementing a responsible innovation framework that enables the OCC to engage in outreach and technical assistance and promote both domestic and international regulatory engagement. We have also moved forward with our announcement to accept applications for special purpose national bank charters from fintech companies engaged in the business of banking, and recently proposed an OCC innovation pilot program to promote responsible innovation within OCC-supervised banks.

In addition to the actions we have taken to date, there are several other areas highlighted within the report that are priorities for our agency and should be areas of focus for Congress as it seeks to better understand the implications of financial technology (fintech) in the United States. For example:

- Open banking and the sharing of customer permissioned financial data has become an area of focus for the OCC. The emergence of data aggregation services and third-party financial service providers offering financial services directly to consumers has created opportunities and benefits for consumers to better manage their financial health. However, as with many new products and services, there are risks that need to be appropriately managed.
- Artificial intelligence is an area that the OCC continues to monitor closely, including use cases and related risks within the banking industry in areas such as BSA/AML and credit underwriting. We are also considering the applicability of existing supervisory rules and guidance, including those pertaining to fair lending and model risk management.
- The OCC continues to monitor and assess banks' potential role in providing short-term, small-dollar loans to consumers. The OCC issued principles in 2018 to encourage responsible lending products of this type. The OCC is also supportive of bank partnerships with fintech firms or other nonbanks, including marketplace lenders, which may help banks meet evolving customer needs in a safe and sound manner.

These are just some examples of the new innovative financial products and business models that have been a focus of the OCC. The OCC created the Office of Innovation to better assess these new products and business models, as well as to support responsible innovation in the federal banking system.

Questions for the Record
Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions"
Date of Hearing: May 16, 2019 Member: Rep. Ben McAdams

To all witnesses:

During the hearing, most witnesses testified regarding the risk cyber threats and attacks could pose to the financial system broadly, and individual financial institutions specifically.

- Will you please explain the extent prudential regulators coordinate with other sectors of the Federal government, including the national security community, to address and respond to growing cyber risks?

Response: As cybersecurity is a constantly evolving and changing risk, the OCC has a designated Critical Infrastructure unit that is responsible for ongoing monitoring of cybersecurity threats and informing supervisory policy. The Federal Financial Institutions Examination Council (FFIEC) has established the Cybersecurity and Critical Infrastructure Working Group, which allows FFIEC members to collaborate and coordinate on addressing threats to the banking system.

The OCC coordinates with other U.S. financial sector agencies through the Financial and Banking Information Infrastructure Committee (FBIIC) sponsored by the U.S. Treasury. The FBIIC has been very focused on harmonization of supervisory approaches for cybersecurity across the broader U.S. financial sector regulatory community. The FBIIC is a primary vehicle for coordination and sharing of information with federal law enforcement and the national security community.

The OCC is also very active in international bodies that are focused on cybersecurity. The OCC participates on the Basel Committee on Banking Supervision's Operational Resilience Group that is focused on different international approaches to cybersecurity supervision in the global banking sector and allows for communication and coordination between international regulatory agencies.

- Additionally, please explain the extent your agencies coordinate with the financial sector (and other private and nonprofit entities) to address and respond to growing cyber risks?

Response: The OCC coordinates with the financial sector on cyber risks in a number of forums, most directly through our supervisory processes for the financial institutions we directly supervise. Through onsite examinations, ongoing monitoring activities, and other channels, the OCC regularly communicates with the financial institutions and technology service providers we supervise. As part of other communication channels, the OCC regularly speaks at various industry conferences and events on cybersecurity, and we regularly host outreach meetings for large, midsize, and community banks that will cover various hot topics, including cybersecurity.

Many of these meetings are targeted for specific audiences including board members, chief executive officers, chief information officers, and chief information security officers.

For the largest financial institutions, the FBIIC members meet formally with the Financial Services Sector Coordinating Council (FSSCC) three times a year. The FSSCC is the private side of the financial sector public-private sector partnership. Along with this communication between regulators and industry stakeholders, the OCC has also emphasized the importance of coordination and information sharing between industry stakeholders. In 2014 the OCC, along with other FFIEC members, issued a joint statement that recommended financial institutions of all sizes participate in the Financial Services Information Sharing and Analysis Center (FS-ISAC). Rapidly evolving cybersecurity risk reinforces the need for all institutions and their critical technology service providers to have appropriate methods for monitoring, sharing, and responding to threat and vulnerability information.

- Do you believe the current levels of coordination are sufficient or could they be enhanced in any specific way?

Response: The OCC is continually seeking opportunities to enhance coordination with regulatory counterparts and industry stakeholders. Currently, our engagement through the FFIEC, FBIIC, and other regulatory groups provides opportunities for information sharing and coordination of supervisory approaches. The OCC also is working with our regulatory counterparts to further harmonize supervisory approaches through a number of initiatives.

- Do you believe you have the statutory, regulatory, and supervisory tools necessary to ensure that cyber risks do not pose a threat to the financial system broadly, or to individual financial institutions specifically?

Response: At this time, we believe the OCC has the necessary statutory, regulatory, and supervisory tools necessary to appropriately supervise cybersecurity risks in the federal banking system.

FSC Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions"
May 16, 2019 in 2128 Rayburn
Rep. Bill Posey statement and questions

- Thank you Madame Chair and Ranking Member McHenry for holding this hearing today.
- Ten years later we are still learning from the financial crisis. How we got to that point is one aspect. Another, is how the Federal Reserve brought the crisis to an end.
- A growing literature cites the Fed's role in stabilizing asset prices. The Fed bought private securities -largely Mortgage Backed Securities (MBS), and expanded its balance sheet dramatically.
- At one point, the Fed was purchasing 90% of new mortgage backed securities. These assets had collapsed in value, and no longer provided reliable collateral to fund them.
- That's the essence of the liquidity crisis. The Fed buying these assets was a little like the Agriculture Department of old propping up commodity prices.
- In the panic, we see the Fed backstopping assets. We seem to have placed a lot of emphasis on the Fed backstopping financial institutions and therefore we talk about "global systemically important banks" and "too big to fail."

- For all the panelists: Some economists believe the emphasis on capital requirements conditioned on perceptions from the financial crisis have unduly restricted capital market expansion and really don't provide a great deal of protection against a liquidity-driven downward spiral in asset prices. Capital—even if insufficient—didn't really go very far in the crisis. The commercial banking system works because we have a clearing system of short-term credit to meet liquidity constraints by banks borrowing overnight when they are short and lending when they are long. Do we need to think about policies or measures to better assure the ability of securities dealers and investment bankers to rollover their credit and keep the asset markets stable and avoid the kinds of liquidity instabilities we saw in the crisis?

Response: A number of policies, practices, and regulations have been developed since the financial crisis that reduce the risk of a liquidity-driven downward spiral and address risks in short-term markets. The Liquidity Coverage Ratio (LCR) was implemented in 2014 to enhance liquidity in the banking system, promote short-term resilience, and reduce short-term liquidity risks in the financial system as a whole. The LCR improves the ability of banks to absorb potential market and liquidity shocks in a severe stress scenario by requiring banks to hold sufficient high-quality liquid assets to cover outflows over a 30-day stress period.

In addition, the banking agencies in 2010 issued an interagency policy statement on funding and liquidity risk management. This interagency guidance addressed policies and practices such as stress testing, liquidity risk management, and contingent funding. It has served as an effective tool, and bank management has used many principles included in the guidance to enhance bank liquidity risk planning and contingent funding to take into account interruptions in short-term funding markets and loss of ability to rollover credits. The LCR, stress testing and enhanced liquidity risk management practices and policies along with the increase in the quantity and quality of capital combine to significantly reduce the likelihood of the liquidity instabilities we

saw in the last crisis from recurring. In addition, the banking agencies carefully monitor through the supervisory process bank liquidity and funding markets to identify any liquidity instabilities that may develop and require enhanced policies or actions.

Liquidity pressures in the derivatives market were alleviated by the clearing mandate, implementation of swap margin rule, and increased compression activities reducing risk in the financial system. Central clearing has reduced bilateral exposure as counterparties benefit from multilateral netting and margin requirements. The margin rule has also pushed certain swaps towards central clearing. Cleared OTC derivatives have increased over the years as a percentage of the total notional.

- For all the panelists: Are current bank capital requirements based on Basel and other research really providing risk reduction benefits that exceed their prospective costs in terms of restricting credit and capital markets?

Response: We believe that the current capital standards appropriately ensure the safety and soundness of our banking system while also supporting a strong and robust economy. The overall capital position, liquidity, and the credit quality at large and small banking organizations have strengthened considerably in recent years, while profitability has also continued to increase. The OCC, in conjunction with the FDIC and FRB (the agencies), continually evaluates the capital requirements to ensure that they meet their objectives in a manner that minimizes unintended consequences and aligns with banking organizations' risk profiles. The OCC is committed to tailoring regulatory requirements to remove unnecessary burden and increase bank lending and investment. To that end, the agencies recently proposed to further tailor capital requirements based on the size, complexity, and overall risk profile of banking organizations. Under the most recently-issued capital proposal,[2] the most stringent standards would continue to apply to banking organizations that present the greatest systemic risks. For other banking organizations, the proposal would refine the application of capital and liquidity standards based on these banking organizations' risk profiles, consistent with safety and soundness and financial stability.

In addition, the OCC strives to ensure that our internationally active banking organizations operate on a level playing field with their foreign counterparts. The agencies are active participants in the Basel Committee and play a significant role in drafting the international standards. Before implementing any of the Basel Committee standards in the United States, we carefully review and consider each standard and subject it to a public notice and comment process, to ensure that the capital standards ultimately implemented are appropriate for our institutions.

- For all the panelists: Legislation under consideration in this hearing would expand oversight by making additional hearings mandatory for the prudential regulators. Shouldn't we hold these hearings when events prompt them rather than blindly require them at recurring intervals? Can we rely on a process of written reports with appropriate issues focus from you and

[2] 83 Federal Register 66024 (December 21, 2018). https://www.federalregister.gov/documents/2018/12/21/2018-27177/proposed-changes-to-applicability-thresholds-for-regulatory-capital-and-liquidity-requirements

our own surveillance of the financial system to alert us to the need for oversight hearings? Do you have any specific ideas in this regard?

Response: The OCC honors requests from the Committee to testify at hearings or to provide information to assist Members in advancing policy discussions in the absence of a statutory requirement to do so. We will continue to provide Congress with information to aid its oversight in the format and with the frequency requested by the Committee. We will also continue to provide all statutorily required reports to Congress.

Chairwoman Maxine Waters
Questions for the Record for Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions"
Thursday, May 16, 2019

Wells Fargo and Megabank Supervision, Enforcement and Accountability

In February 2018, the Federal Reserve imposed an asset cap of $1.95 trillion on Wells Fargo to address widespread consumer abuses and compliance breakdowns by the megabank until it cleans up its operations. In April 2018, the OCC issued a civil money penalty of $500 million against the bank for similar misdeeds. However, these penalties are just the cost of doing business, as Wells Fargo earned nearly $6 billion in profits the first three months of this year alone. Even the Fed's asset cap has not corrected a culture of bad behavior and mismanagement that has resulted in harm for millions of Americans. Given that the regulators' actions have not resulted in real changes at the bank, it is past time for Congress to step in. So on March 12th, the Committee invited the then-CEO of Wells Fargo, Tim Sloan, to testify before the Committee, and after a few hours of tough but fair questioning, he stepped down from his position a few days later. Additionally, the Committee held a hearing with the CEOs of the other seven U.S. G-SIBs on April 10, 2019. The hearing highlighted that while U.S. G-SIBs made $780 billion in profits the last 10 years, they paid at least $163.7 billion in fines for a litany of violations of law, many of which resulted in consumer harm, underscoring that fines amount to the cost of doing business and do not appear to serve as a strong enough enforcement tool to deter future abuses.

1. Comptroller Otting, the OCC put out a statement immediately following the Committee's March hearing that, "We continue to be disappointed with Wells Fargo Bank's performance under our consent orders and its inability to execute effective corporate governance and a successful risk-management program. We expect national banks to treat their customers fairly, operate in a safe and sound manner, and follow the rules of law." Is the agency considering enhancing the penalties imposed on this recidivist megabank beyond civil money penalties? If you don't, what signal is the OCC sending to banks that follow the law?

Response: The OCC continues to monitor the progress of Wells Fargo in complying with the requirements of the OCC's existing enforcement actions. The OCC's actions against Wells Fargo Bank send a clear message to the banking industry regarding OCC expectations for risk management and the fair treatment of consumers. In April 2018, the OCC issued a $500 million civil money penalty (CMP) against the bank and entered into a comprehensive consent order covering compliance risk management. It remains the largest civil money penalty assessed against a bank by a federal banking regulator.[3] Notably, the April 2018 consent order places significant ongoing requirements on the bank, including requiring OCC supervisory non-objection for significant customer remediation plans and ongoing reporting related to customer remediation. Moreover, since 2016, the OCC has subjected the bank to restrictions that require it to seek regulatory review before making changes to its board or senior management or making payments to outgoing senior executives. The OCC will continue to use all appropriate tools,

[3] The OCC also issued a $500 million CMP against HSBC Bank USA in 2012.

including its broad authorities available under 12 U.S.C. 1818, to ensure Wells Fargo complies with enforcement actions and that it operates in a safe and sound manner, provides fair access, treats customers fairly, and complies with the law.

5. Comptroller Otting, why did the OCC not agree with nearly all of GAO's recommendations for how to mitigate regulatory capture? If your agency will not implement those recommendations, should Congress consider legislation to compel the OCC to implement those changes?

Response: The GAO identified no instances of regulatory capture and no cases where employee behavior or judgment evidenced industry-bias or lack of independence, consistent with conclusions from the 2013 international peer review of OCC large bank supervisory processes. We therefore disagree that the documentation concerns suggested by the GAO increase the risk of regulatory capture. The risk of regulatory capture is controlled through subjecting supervisory decisions to multiple levels of review and quality management. While the OCC remains fully committed to promoting vigilant supervision and independence, the majority of the GAO's recommendations are unnecessary and do not advance this aim. Please see the attached OCC response letter (Attachment 1), which provides more detailed responses for each recommendation.

The GAO addressed some of OCC's existing processes and procedures to mitigate the risk of regulatory capture and, in its findings, identified activities that in the GAO's opinion may improve documentation on these matters. We appreciate the challenge involved in trying to measure the risk of regulatory capture, and we understand the natural tendency in the face of such a challenge to focus on documentation. We agree that documentation can be improved on some matters, and we have already taken steps to implement the relevant GAO's recommendations.

Deregulating Megabanks - Capital, Leverage, Stress Testing, Living Wills

Soon after President Trump assumed office, he said that, "[We're going to do a big number on Dodd-Frank," and he tasked the Treasury Department to design the roadmap. Treasury issued a series of reports with dozens of deregulatory recommendations to roll back capital, leverage, stress testing and other safeguards, and Secretary Mnuchin recently said he was pleased at how regulators were implementing those suggestions.

To that end, regulators have advanced several proposals to change prudential requirements for the largest banks. In April 2018, the Federal Reserve issued a set of proposals to revise its capital rules for G-SIBs and introduced a "stress capital buffer," or SCB, which would in part integrate the forward-looking stress test results with the Board's non-stress capital requirements.4 The Federal Reserve joined the OCC in releasing a second proposal to substantially alter the current enhanced supplementary leverage ratio (eSLR) that applies to G-SIBs.5 The FDIC estimated the eSLR proposal would lower capital requirements for the primary federally-insured bank subsidiary of each G-SIB by a combined $121 billion. In October 2018, the Federal Reserve, FDIC and OCC released proposals to implement S. 2155 that would tailor the application of prudential standards to large banks, proposing to establish four categories of large banks based

on asset size and cross-border activity. In March 2019, the Federal Reserve decided not to deploy the countercyclical capital buffer that would require large banks to build additional capital, and made revisions to the stress-testing regime to limit the use of the "qualitative objections" which may make it easier for large banks to pass their stress tests. In April, regulators proposed easing prudential standards for foreign banks, and modifying large bank resolution plans (referred to as "living wills") so that for many large banks would submit plans every three years.

These proposals have received a range of criticisms, including opposition from Federal Reserve Governor Lael Brainard and FDIC Board Member Marty Gruenberg. Former Federal Reserve Governor Dan Tarullo described these proposals as "low-intensity deregulation," explaining these roll backs come at a cost. In a research note by Fitch Ratings, analysts noted that a proposal issued recently by the Federal Reserve and FDIC to extend the living will deadlines for G-SIBs from annual submission to every other year would be a "negative" credit event for those financial institutions, writing, "As regulatory requirements continue to ease on the margin for the largest banks, risks inherent to their complexity can be further exacerbated by the loss of comparative data from annual resolution planning and stress testing data."

6. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, please provide the Committee with a list of proposals that your agency has made, or is planning to make, that is responsive to recommendations by the Department of the Treasury in its series of regulatory reform reports and memoranda issued in 2017 and 2018.

Response: The OCC has made or finalized the following proposals consistent with the regulatory reform reports and memoranda issued by the Department of Treasury in 2017 and 2018.

Aligning the financial system to help support the US economy
CRA Reform: The OCC issued an advanced notice of proposed rulemaking as the first step to modernize the regulatory framework around CRA to better serve its original purpose and encourage more investment and banking activity supporting the people and communities needing it most. The OCC has shared all of the comments from the advanced notice of proposed rulemaking with the other federal banking regulators, and we are working with them to jointly develop and issue a proposed rule later this year. Consistent with the Treasury report and our own observations and experience supervising the banks and savings associations which conduct more than 60 percent of all CRA activity, the OCC believes CRA regulations can be improved to encourage more lending, investment, and services where they are needed most by clarifying what qualify for CRA consideration, updating where activity counts, creating a more objective means for evaluating CRA performance, and making reporting more timely and transparent.

Special Purpose National Banks: After prudent and careful consideration, the OCC announced in July 2018 its decision to consider applications for special purpose national bank charters from qualifying fintech companies engaged in the business of banking. This decision is consistent with bipartisan government efforts at federal and state levels to promote economic opportunity and support innovation and will help to provide more choices to consumers and businesses.

Reducing regulatory burden by decreasing unnecessary complexity
Short Form Call Report: The OCC (jointly with the FDIC and FRB) published a final rule in June 2019 providing for reduced reporting requirements on Call Reports for the first and third quarters for institutions with less than $5 billion in total consolidated assets. This change expands the number of community institutions that can free up employees and other resources to serve customers and the operational needs of the institutions. (Section 205 of the Economic Growth Act)

Appraisals of Residential Real Property: The OCC (jointly with the FDIC and FRB) issued a notice of proposed rulemaking in December 2018 to increase the appraisal threshold for residential real estate transactions in order to reduce regulatory burden, particularly in rural areas, in a manner that is safe and sound and consistent with consumer protection. The comment period closed in February 2019, and the agencies are working to issue a final rule later this year. (Section 103 of the Economic Growth Act)

Volcker Rule: In July 2018, the OCC (jointly with the CFTC, FDIC, FRB, and SEC) published a notice of proposed rulemaking to simplify and tailor compliance requirements for the Volcker Rule to provide banking entities with clarity about what activities are prohibited and to improve supervision and implementation of prohibitions in the rule. The agencies extended the comment period in September 2018 and are now reviewing and assessing the comments received. The agencies expect to issue a final rule addressing many of the comments received later this year.

Community Bank Leverage Ratio: The OCC (jointly with the FDIC and FRB) issued a notice of proposed rulemaking in February 2019 to provide a simplified measure of capital adequacy for qualifying community banking organizations. The proposal addresses the complex and burdensome process of calculating and reporting regulatory capital. The agencies are reviewing the comments received on the proposal, with the goal of issuing a final rule by September of this year. (Section 201 of the Economic Growth Act)

Capital Simplification (MSAs, DTAs, Investments in other financial institutions): In September 2017, the OCC (jointly with the FDIC and FRB) issued a proposal to reduce regulatory burden by simplifying the capital treatment for mortgage servicing assets, certain deferred tax assets, investments in the capital instruments of unconsolidated financial institutions, and minority interest. The agencies issued a final rule in July 2019. To allow time necessary to accommodate changes that must be made to banks' regulatory reports, the final rule will become effective on April 1, 2020.

High Volatility Commercial Real Estate: The OCC (jointly with the FDIC and FRB) issued a notice of proposed rulemaking in late 2018 to implement revisions that would limit the types of acquisition, development, and construction loans that may be considered high volatility commercial real estate (HVCRE) exposures and subject to heightened capital requirements. The agencies published a second notice in July, which proposed additional changes designed to clarify when a land development loan should be considered an HVCRE exposure.[4] The agencies

[4] "Agencies Propose Rule on the Capital Treatment of Land Development Loans," *available at*: https://www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-77.html.

intend to finalize this rulemaking in October of this year. (Section 214 of the Economic Growth Act)

Tailoring regulatory approach based on size and complexity of regulated firms
Examination Cycle: In December 2018, the OCC (jointly with the FDIC and FRB) issued rules finalizing expanded eligibility for an 18-month examination cycle. This change allows the agencies to better focus supervisory resources on financial institutions that are more likely to present capital, managerial, or other supervisory issues and thus enhance safety and soundness collectively for all financial institutions. (Section 210 of the Economic Growth Act)

Volcker Rule: In July 2019, the OCC (jointly with the CFTC, FDIC, FRB, and SEC) finalized a rulemaking to conform the Volcker Rule implementing regulations with Sections 203 and 204 of the Economic Growth Act. These revisions exclude community banks with $10 billion or less in total consolidated assets and total trading assets and liabilities of 5 percent or less of total consolidated assets from the restrictions of the Volcker Rule and ease Volcker Rule restrictions on common names between certain bank affiliates and sponsored funds. These changes provide regulatory relief to institutions that do not pose the types of risks the Volcker Rule was intended to limit. (Sections 203 and 204 of the Economic Growth Act)

Tailoring Capital and Liquidity Requirements: The OCC (jointly with the FDIC and FRB) recently proposed rules to establish risk-based categories for determining applicability of requirements under the regulatory capital rules, the LCR rules, and the proposed net stable funding ratio rules for large banking organizations. These proposals build upon the agencies' existing practices of tailoring capital and liquidity requirements based on the size, complexity, and overall risk profile of banking organizations. The proposals are consistent with provisions of the Economic Growth Act that raises the minimum asset threshold for application of enhanced prudential standards from $50 billion to $250 billion in total consolidated assets.

Stress Testing: In February 2019, the OCC (jointly with the FDIC and FRB) published a notice of proposed rulemaking to raise the minimum asset threshold for banks covered by the company-run stress testing requirement from $10 billion to $250 billion in total consolidated assets; revise the requirement for banks to conduct stress tests from annually to periodically; and reduce the number of required stress test scenarios from three to two. The agencies are working toward issuing a final rule. (Section 401 of the Economic Growth Act)

Aligning regulations to support market liquidity, investment, and lending in the US economy
Municipal Securities as High Quality Liquid Assets: In August 2018, the OCC (jointly with the FDIC and FRB) issued an interim final rule amending the Liquidity Coverage Ratio rules to treat qualifying liquid and readily marketable, investment grade municipal securities as level 2B liquid assets. The agencies finalized the rule in June. (Section 403 of the Economic Growth Act)

Small Dollar Lending by Banks: To encourage banks to offer responsible short-term small-dollar installment loans to help meet the credit needs of their customers, the OCC published a bulletin in May 2018 describing the core principles for these products. The bulletin also highlighted reasonable policies and practices specific to short-term small-dollar installment lending. The

federal banking agencies are exploring principles-based options to address remaining regulatory uncertainty and to further encourage banks to offer sound and, fair short-term credit products that support the long-term financial health of their customers.

Supplementary Leverage Ratio (SLR): In April 2019, the OCC (jointly with the FDIC and FRB) issued a proposal to amend the SLR to exclude qualifying deposits at a central bank for banking organizations that are predominantly engaged in custody, safekeeping, and asset servicing activities. The agencies are reviewing comments and working towards a final rule this year. (Section 402 of the Economic Growth Act)

Calibration of the Enhanced Supplementary Leverage Ratio (eSLR) for US GSIBs: In April 2018, the OCC (jointly with the FRB) issued a notice of proposed rulemaking to recalibrate the eSLR for US GSIB holding companies and their insured depository institution subsidiaries. The agencies have reviewed the comments received and are re-evaluating this proposal in light of changes to the supplementary leverage ratio required by section 402 of the Economic Growth Act.

Fintech

There has been tremendous interest in financial technology, or fintech, and the Committee has formed two task forces to more closely examine fintech and AI.

14. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles: GAO issued a recent report making a series of recommendations that the regulators coordinate better on fintech issues. Please outline what specific steps your agency is taking to respond to these recommendations, and coordinate better with other regulators?

Response: The OCC has continued to facilitate, engage, and participate in discussions with other relevant financial regulators on matters regarding data aggregation. The OCC continues to utilize forums such as the Federal Financial Institutions Examination Council's Task Forces on Supervision and Consumer Compliance, and the Interagency Fintech Discussion Group to discuss issues arising from data aggregation with other regulators. The OCC also works closely with interagency partners as part of the Basel Committee on Banking Supervision Task Force on Financial Technology to better understand the risks and concerns associated with the sharing and aggregation of consumer data. The OCC remains focused that the sharing of customer sensitive information should be done in a safe and sound manner, with appropriate consumer protections and in compliance with applicable laws and regulations. This is one of many topics about which the OCC engages in collaborative discussions with other relevant financial regulators.

17. Comptroller Otting, in a document released by the OCC titled "Exploring Special Purpose National Bank Charters for Fintech Companies," the agency cited 12 U.S.C.§1, 12 U.S.C. § 1461, and 12 U.S.C. 3102 as statutory authority to grant banking charters to fintech companies. However, the plain language reading of the statute does not clearly indicate that your office has authority to create a fintech charter, and we understand the state banking regulators are challenging the OCC on this issue. This is underscored by a recent paper by the Bipartisan Policy Center suggesting the OCC was stretching its existing authority.11 What kind of legal analysis

did the OCC do before accepting applications for its fintech charter? Will you share the agency's legal analysis with the Committee? How many draft applications is the OCC considering or otherwise aware of, and what kind of business models do these entities have?

Response: The OCC has outlined its analysis in its submissions to the court in the litigation challenging the OCC's authority to charter a special purpose national bank that does not take deposits. See, for example, the attached memorandum in support of the OCC's motion to dismiss (Attachment 2). The OCC's long-standing regulation regarding special purpose national banks (12 C.F.R. 5.20(e)) provides that a national bank need only be engaged in one of the three core banking functions—receiving deposits, paying checks, or lending money—in order to be engaged in the "business of banking." The interpretation reflected in this regulation aligns with the context and structure of the National Bank Act and controlling Supreme Court and D.C. Circuit case law. There are no draft applications for a non-depository fintech charter currently under active consideration.

18. Comptroller Otting, you recently announced your innovation pilot program with a deadline for comments by June 14, 2019. Are there any safeguards, products, or frameworks the OCC may be specifically interested in this space?

Response: The OCC does not endorse or prioritize any particular technology or activity that may be included within the pilot program. The program is intended to support testing of novel or innovative products, services, or processes (activities) that could present significant opportunity or benefits to consumers, communities, businesses, and financial institutions. The program would focus on innovative activities where regulatory uncertainty is perceived to be a barrier to development and implementation.

Based on the Office of Innovation's ongoing outreach and technical assistance efforts, some areas that may be of interest could include how artificial intelligence may be leveraged to improve anti-money-laundering compliance, the use of alternative data in short-term small-dollar lending, and how banks may use distributed ledger technology. The OCC is interested in industry feedback on potential areas of interest for the pilot program and has sought comment on this particular question within the "OCC's Innovation Pilot Program" paper, issued April 30, 2019. Interest in the program will depend on the individual facts and circumstances of each financial institution. Ultimately, the goal of the program is to provide eligible entities regulatory input early in the formation of those activities, and would foster the development of appropriate controls during a pilot and as those activities scale.

Volcker Rule

I would like to discuss recent statements by all of you about banking regulators making headway on efforts to streamline Volcker Rule compliance. It seems that these statements rarely offer any specifics.

21. Comptroller Otting, in the SEC's cost-benefit analysis of the proposed rule to modify the Volcker Rule, they wrote on page 429, "[W]e recognize that the proposed amendment could increase moral hazard risks related to proprietary trading by allowing dealers to take positions

that are economically equivalent to positions they could have taken in the absence of the 2013 final rule." Why is the OCC supporting a modification to the Volcker Rule that will increase, not decrease moral hazard risks?

Response: This economic analysis was conducted by the SEC, and it relates only to SEC-regulated dealers. The OCC does not believe the proposed revisions to the Volcker Rule hedging exemption would allow banking entities to engage in impermissible proprietary trading. In the preamble to the proposed rule, the five Volcker Rule agencies explained that the proposed changes to the hedging exemption were intended to implement effectively the statutory hedging exemption. The statutory hedging exemption applies to activities that are designed to reduce specific risks to the banking entity. The proposed revisions would continue to require that a banking entity's risk-mitigating hedging activities—including any adjustments to the hedging activity—be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks that the banking entity incurs.

Community Reinvestment Act

The Community Reinvestment Act ("CRA") was designed to equalize the financial playing field by encouraging banks to meet the credit needs of consumers in low income neighborhoods. Specifically, the CRA was designed to address discriminatory policies such as redlining. Unfortunately, Reveal by the Center for Investigative Reporting published several articles after its yearlong investigation based on 31 million records publicly available under the Home Mortgage Disclosure Act ("HMDA") to identify lending disparities. According to their reporting, "Fifty years after the federal Fair Housing Act banned racial discrimination in lending, African Americans and Latinos continue to be routinely denied conventional mortgage loans at rates far higher than their white counterparts." Specifically, the data showed black applicants were turned away at significantly higher rates than whites in 48 cities, Latinos in 25, Asians in nine and Native Americans in three. Their investigation found modern-day redlining in 61 metro areas across the country.

23. Comptroller Otting, many have expressed concerns that your efforts to modernize CRA is really aimed at making the test easier for banks to pass, even though 98 percent of banks already do. As you continue to develop your proposal, how will it reverse the trends we continue to see with redlining while ensuring the test is rigorous for banks?

Response: The goals for a modernized CRA regulatory framework do not include making it easier for banks to achieve satisfactory ratings. Rather, the goal for a modernized regulatory framework is to encourage additional CRA activity by setting clear standards regarding how banks are evaluated, what types of activities qualify for consideration, and where and when qualified activities are considered in evaluating a bank's CRA performance. We believe a modernized CRA will encourage banks to increase lending and investment in communities that need it most.

24. Comptroller Otting and Chairman McWilliams, what are the ways CRA can be improved so that minority depository institutions are able to play a larger role in addressing a lack of affordable credit in too many of our communities?

Response: The CRA is a powerful tool for community revitalization and has encouraged billions of dollars for investments in affordable housing. The OCC believes that the CRA regulations can be strengthened to increase incentives for minority banks to finance affordable housing by clarifying what multifamily rental housing finance activities qualify for CRA consideration and updating where activities count. The OCC's Advance Notice of Proposed Rulemaking specifically asked about how greater clarity might be provided as it relates to ventures undertaken by non-minority-owned institutions with minority banks. Based on comment letters received, the OCC believes that expanded partnerships between non-minority-owned banks and minority banks could result in increased activity in a number of areas, including affordable housing loans and investments. OCC's strongly supports such partnerships through our Minority Depository Institutions Advisory Council and our Minority Depository Institutions Collaborations Roundtables which are discussed in the 2018 OCC publication "Profitable Partnerships: Collaborating With Minority Depository Institutions."

Payday Loans and Small Dollar Credit

Some of the biggest concerns regarding payday loans and the small-dollar credit industry are that consumers end up in "debt traps" whereby consumers are borrowing one loan to pay off another. On April 30th, our Consumer Protection and Financial Institutions Subcommittee held a hearing entitled "Ending Debt Traps in the Payday and Small Dollar Credit Industry." Rev. Dr. Haynes from the Friendship West Baptist Church in Dallas, TX, testified about one his congregants, stating "One of my members, a 74-year-old senior citizen, who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer. Now she feels like the devil answered her prayer. She is on a fixed income and when the repayment was due, she didn't have enough and had to take out another loan to pay the first one. She ended up with a dozen loans. When she approached me for help one Sunday after church, this once proud senior saint with good credit, was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620%! She was "dealt a bad hand with a bad plan." She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse."

29. Comptroller Otting, consumer groups have expressed concerns that, even though the OCC and FDIC helped to curb these practices in 2013, banks may look to offer another form of "deposit advance loans" that were dangerous for consumers just a few years ago. What steps is the OCC taking to ensure there are no predatory features in any small dollar loans a bank may offer?

Response: The example you highlight is just one of the many reasons we should give consumers more choices for responsible short-term credit options within the highly regulated space of commercial banking. Fewer choices have allowed less scrupulous lenders to fill the gap vacated by federally regulated banks. It is unfortunate, but to the extent that abusive payday lending occurs today, it does so through the patchwork of state-licensed and state-regulated nonbank lenders. Banks should be part of the solution, and the steps OCC has taken encourages banks to responsibly meet the needs of their customers.

The OCC has longstanding guidance that provides advice to its supervised institutions on avoiding abusive and predatory lending practices, including in small-dollar lending (see AL 2000-7, AL 2000-10). The OCC most recently reminded supervised institutions of this guidance in the 2018 bulletin describing the core lending principles for prudently managing the risks associated with offering short-term small-dollar installment lending programs (see Bulletin 2018-14). Longstanding OCC guidance establishes the framework within which the OCC analyzes whether acts or practices associated with products, services, or transactions are potentially unfair or deceptive acts or practices (UDAP) under Section 5 of the Federal Trade Commission Act (see AL 2002-3). As part of the OCC's regular supervisory processes, bank practices are reviewed for potential UDAP issues, and the OCC has cited violations when they have been identified.

31. Comptroller Otting, Chairman McWilliams, Chairman Hood, and Vice Chairman Quarles, what kinds of measures can you as regulators put in place to ensure that banks aren't charging interest rates above 36%?

Response: The individual states set limits on the interest rates or financing costs charged to borrowers for different loan products. The OCC does not have authority to set product process or interest rates. The OCC evaluates banks for compliance with state usury laws governing interest rates and financing costs, as applicable.

Diversity and Inclusion - OCC

OCC's 2018 OMWI report explained that females and minorities in the agency's Executive Coaching Program are at 44.0 percent and 31.2 percent, respectively. OCC also launched its LEAD Program, an enterprise-wide program designed to build leadership competencies for aspiring team leaders and managers.

38. Comptroller Otting, while acknowledging that such targeted coaching and training can be effective steps in getting qualified women and minorities into the leadership pipeline, what is the actual promotion success rate of women and minority participants in the coaching and LEAD programs?

Response: Since both programs are relatively new, we do not have data to support actual promotions yet. The OCC Coaching program is available to employees as they progress through their careers. Many have taken advantage of an Executive Coach both before and after being promoted into higher level positions.

The LEAD program was launched in October 2018 and has 17 participants of which 53 percent are female and 24 percent are minority. This inaugural cohort is slated to continue until October 2020. Our intent is to conduct post program studies of each LEAD cohort to track promotion rates of participants.

39. Comptroller Otting, how many of these aspiring employees, if any, are actually a part of OCC's succession plan? And if they are not, please explain what you plan to do to ensure that

the return on the investment OCC has made in developing aspiring leaders is fully realized through the promotion of women and minorities to the senior ranks?

Response: Our succession management processes have evolved over time. We are currently working on a redesigned succession process to make it more standardized and automated, while making the data more actionable. Notable changes we have made recently include:

- Establishing key succession management positions—focusing on key positions that represent the greatest risk to the agency, if not filled;
- Allowing employees to opt-in to participate in the succession process, rather than being included by their manager, in an effort to ensure a broad talent pool and to mitigate any bias in the process;
- Using a competency assessment tool based on our OCC Leadership competency model, to assess those who aspire for key succession positions. This assessment tool provides an objective and standard way to assess individuals and helps to mitigate unintended bias.

While success planning helps ensure a broad diverse pool of eligible candidates, it must be recognized that filling positions often requires a competitive process to comply with federal hiring rules.

Diversity and Inclusion - Full Panel

In June 2015, your agencies along with the SEC and the CFPB adopted the Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies. Despite urging from many Democrats that those standards for diversity assessments be mandatory and publicly disclosed by regulated entities, the final standards were voluntary, leaving an opportunity for continued opaqueness about industry diversity and inclusion. Under the voluntary standards, our review of your most recent OMWI reports reveals that each of your agencies have low participation by your regulated entities in completing the requested diversity and inclusion self-assessment. For example, among your respective regulated depository institutions, only 16% reported to FDIC; 9.3% reported to OCC; 6.0% reported to the Fed; and a mere 1.5% reported to NCUA the results of their diversity self-assessments.

43. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, what plans have you discussed with your OMWI directors and your regulated entities about how to increase participation in providing diversity self-assessments?

Response: The OCC's Executive Director of OMWI Joyce Cofield and I have discussed plans to engage OCC institutions in an informational summit, similar to the Diversity and Inclusion Summit that occurred in New York in September 2018. OCC-supervised institutions in the northeastern part of the country were specifically invited to this event, where Ms. Cofield and other federal financial regulatory OMWI directors provided updates on the implementation of the Joint Standards for Assessing Diversity Policies and Practices and offered insights about leading diversity practices in the financial services industry. The OMWI directors are planning the next Diversity and Inclusion Summit this fall in Chicago to connect with institutions in the Central

and Midwestern sections of the country. The Summit will enable directors to encourage institutions to conduct and submit diversity self-assessments and also hear from diversity champions in the financial services industry. In addition to the next Summit, Ms. Cofield is also working with the OCC's Office Public Affairs to identify outreach venues through bankers' associations and explore the use of webinars to promote diversity self-assessments.

44. For the diversity data that has been shared, what type of analysis and advice, if any has been shared about regulated entities' diversity and inclusion efforts?

Response: OMWI conducted analyses of 2016 and 2017 diversity self-assessments received from OCC-supervised institutions that met the 100 and over employee threshold to which the Standards apply. Our review disclosed that most institutions have written, board-approved diversity and inclusion policies; consistently report out diversity information to the board and executive leadership; hold annual or periodic Diversity and Inclusion (D&I) training for staff; set annual goals for supplier diversity; and actively reach out to and engage with D&I professional organizations. Our analyses also revealed the emergence of several leading practices within institutions, such as the creation of D&I councils comprised of senior leaders from lines of business; use of metrics to assess workforce employment and procurement D&I progress and trends; diversity dashboards or performance scorecards used as measurement and accountability tools for management and boards; and evaluations and/or specific requirements of Tier II suppliers to ensure diversity in procurement activities. These successes and leading diversity practices in D&I were shared with the institutions who participated in the fall 2018 Diversity and Inclusion Summit.

45. What type of guidance has been provided to bank examiners on how to evaluate diversity and inclusion practices at regulated entities?

Response: OCC's supervision lines of business are informed of all letters and communications to institutions regarding diversity self-assessments. However, the review of diversity assessments is conducted by the OMWI staff rather than bank examiners, as the assessments are not included in supervisory activities and do not impact supervisory ratings of the institutions. Bank examiners are urged to defer any questions related to diversity policies, practices, and self-assessments to the OMWI staff.

46. At your agencies, who do OMWI directors report to and to what extent are OMWI directors and other leadership at your agencies, including you, accountable for diversity results?

Response: At the OCC, Joyce Cofield is the Executive Director of OMWI, and she reports directly to, and meets monthly with, the Comptroller to discuss all diversity matters relative to the agency. Ms. Cofield provides regular diversity briefings to senior leaders of each line of business during which she discusses diversity data specific to the leader's unit. She advises OCC senior leaders of opportunities for improvement and engages with them to develop and enact strategies and tactics to appropriately address concerns.

Incentive-Based Compensation

The Wells Fargo fraudulent account scandal, and its incentive-based cross-selling strategy that fueled it, is a stark reminder how important it is for financial regulators to finalize executive compensation rules. As you know, Section 956 of the Dodd-Frank Act directed the regulators to adopt joint rules aimed at prohibiting incentive compensation arrangements that could encourage inappropriate risks at financial institutions. The regulators made an initial proposal in 2011, then reworked the proposal and issued a new plan in 2016. The proposal increases in stringency based on the financial company's asset size with enhanced requirements for senior executive officers and significant risk-takers.

47. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, there was much discussion at the hearing regarding the fast implementation of S. 2155 enacted by the 115th Congress. However, there are a few much older mandates that your agencies have not yet finalized. For example, given that Section 956 of the Dodd-Frank Act regarding incentive-based compensation is not a discretionary requirement, but a mandatory one, what steps are each of your agencies taking to prioritize the rule's implementation and enforcement this provision of the law?

Response: Finalizing a rule under section 956 of the Dodd-Frank Act is an OCC priority. The OCC is in active discussions with the SEC, FRB, FDIC, FHFA, and NCUA about how best to achieve this goal.

48. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, please provide the Committee with a timeline for each specific mandate required by S. 2155 from the 115th Congress and the Dodd-Frank Wall Street Reform and Consumer Protection Act that requires a rulemaking that your agency has yet to be finalized.

Response: Attached please find a chart providing information about the timeline for each rule required to be issued by the OCC under the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) (Attachment 3). The OCC has completed the vast majority of rulemakings required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Of the many rules required by the Dodd-Frank Act, only five OCC rules remain outstanding. All of these outstanding rules involve joint action or coordination with other financial regulatory agencies. The outstanding rules are:

- Section 616(d). This section requires a joint rulemaking by the FRB, FDIC, and OCC to implement source of strength requirements relating to bank holding companies. In 2016, the OCC and FDIC prepared a draft NPR, which was shared with the FRB. The OCC will reengage with the FRB and FDIC with the intent to complete the joint rule.
- Section 956. This section requires the OCC, FRB, FDIC, SEC, FHFA, and NCUA to issue joint rules or guidelines relating to incentive-based compensation. The OCC is working with our colleagues at the SEC, FRB, FDIC, FHFA, and NCUA on a revised draft rule.
- Section 1025. This section requires each of the CFPB, OCC, FRB, FDIC, and NCUA to issue rules to provide safeguards from retaliation against insured depository institutions and officers and employees that institute an appeal asserting the CFPB and the prudential regulator issued inconsistent supervisory guidance. This rulemaking has not yet begun.

- Section 1473(e). This section affected the appraisal regulations issued by each Federal banking agency under Title XI of FIRREA identifying the threshold for residential mortgages requiring a full written appraisal. The OCC issued a notice of proposed rulemaking to increase the residential real estate appraisal threshold on Dec. 7, 2018. Drafting of the final rule and consultation with the CFPB is currently in progress.
- Section 1473(q). This section requires the OCC, FRB, FDIC, NCUA, FHFA, and CFPB to issue rules establishing quality control standards for automated valuation models to ensure confidence in estimates produced. The agencies have made progress in identifying and clarifying the issues that will be need to be addressed for this rulemaking.

49. Comptroller Otting, you have recently suggested regulators will try to complete this long overdue rulemaking soon. What is the timeline for action, and should we expect to see a completely different proposal compared to the one the regulators released in 2016? How will the rule that you are working on properly disincentivize the kind of behavior we have seen at Wells Fargo the past few years?

Response: I cannot speak for my colleagues at other agencies, but personally I would like to complete the rulemaking under section 956 as soon as possible, and I am making every effort to meet that goal. I look forward to working with my colleagues on a principles-based final rule that gives regulators and financial institutions the tools to disincentivize the kinds of behavior that may have contributed to behaviors leading to enforcement action against Wells Fargo while ensuring that financial institutions have the flexibility they need to build incentive compensation arrangements that attract and retain talented personnel.

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

As regulators, you have indicated that relieving the burdens on banks, especially those placed on banks through the Bank Secrecy Act is a highest priority. While compliance is expensive, the trade off in lowering BSA compliance standards is potentially weakening safeguards to combat terrorists and criminal activity where their financing flows through the U.S. financial system.

50. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, banks and credit unions often complain they do not receive meaningful feedback on whether their efforts on BSA/AML are helpful to law enforcement. What steps is your agency taking to provide better feedback and guidance to community banks and credit unions?

Response: The OCC's objective when examining banks for compliance with the requirements of the Bank Secrecy Act is to ensure supervised financial institutions have in place adequate BSA/AML compliance programs that are, among other things, designed to provide useful information to law enforcement. As a part of these examinations, OCC provides banks feedback on the adequacy of suspicious activity monitoring systems utilized by banks to screen transaction activity conducted through or attempted through the institution. In addition, OCC representatives provide outreach to the industry by participating in panel discussions and serving as speakers at widely-attended industry conferences, trade association meetings and similar events wherein we provide feedback regarding the overall adequacy of BSA/AML compliance programs. Finally, the OCC is an active member of both the Regulatory Reform Working Group (RRWG) and

FinCEN's Bank Secrecy Act Advisory Group (BSAAG). The RRWG was formed in 2018 by the principals of the agencies and works to identify opportunities to enhance the effectiveness and efficiency of the U.S. AML regime. The BSAAG provides opportunities for regular interaction among industry, law enforcement, and regulators.

What steps is your agency taking to ensure law enforcement has all the information it needs to combat terrorism and illicit activity?

Response: As mentioned above, the OCC's objective when examining banks for compliance with the requirements of the Bank Secrecy Act includes ensuring supervised financial institutions have in place adequate BSA/AML compliance programs that are designed to provide useful information to law enforcement. As a part of their BSA/AML compliance programs, supervised banks file required reports with FinCEN and FinCEN provides this highly useful information to law enforcement. Additionally, as mentioned above the OCC is an active member of FinCEN's BSAAG, which offers opportunities for participants from industry, law enforcement and the federal banking agencies to interact regarding information that is useful to law enforcement.

Financial Stability and Lessons from the Financial Crisis

51. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, earlier this week, former Fed Chairs Bernanke and Yellen, along with former Treasury Secretaries Geithner and Lew, wrote a letter to Chairman Powell and Secretary Mnuchin about a proposal by FSOC to make it much harder to designate a future AIG that poses a systemic risk to the financial system. The former officials wrote, "Though framed as procedural changes, these amendments amount to a substantial weakening of the post-crisis reforms. These changes would make it impossible to prevent the buildup of risk in financial institutions whose failure would threaten the stability of the system as a whole." Given these significant concerns, will FSOC reconsider its proposed guidance that would, in the words of these officials, "neuter the designation authority"?

Response: In early March, FSOC issued a proposal to implement an activities-based approach for identifying potential market-wide risks and to amend the process for designating nonbank financial companies systemically important. Comments were due May 13. Council staff is now carefully assessing the comments received in response to the notice and request for comment, including the letter from the former Treasury Secretaries and Chairs of the Federal Reserve Board.

52. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, given that FSOC is taking a so-called "activities-based approach" to supervising for systemic risk, is that any different than the weak financial stability oversight we had before the financial crisis, especially since FSOC has no authority to mandate new regulations to address systemic concerns identified through an activities-based approach?

Response: The proposal to revise the nonbanks interpretive guidance, which is consistent with the recommendations in the November 2017 U.S. Treasury Report, ensures FSOC continues to serve its primary function in a transparent, efficient, and effective manner. The proposal shifts

the FSOC's focus to an activities-based approach for identifying potential market-wide risks to financial stability. This approach would rely on the expertise of the primary regulators to address the identified risks. Entity designation is still a possibility. Should the FSOC consider designating a nonbank financial company as systemically important, the proposal includes positive changes to the process. Such changes include the addition of a determination of the likelihood of the company experiencing material financial distress and an analysis of benefits and costs.

55. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, has the Financial Stability Oversight Council (FSOC) helped to eliminate regulatory gaps in our financial regulatory system? Should Congress consider legislation to strengthen FSOC's tools to ensure it is well equipped to head off a future crisis?

Response: Congress established the Council to identify, monitor, and respond to systemic risk. The FSOC brings together its member agencies to fulfill this critical mission. Through its committees and staff, the FSOC provides a formal, structured process for communicating, coordinating, and responding to emerging market and industry developments, as well as to unforeseen events. Congress gave the Council broad discretion to determine how to respond to potential threats to U.S. financial stability. I am fully supportive of the Council's proposal to move to an activities-based approach for identifying potential market-wide risks to financial stability, which would rely on the expertise of the primary regulators to address the identified risks. If, after engaging with the primary regulators, the Council finds that those regulators' actions are insufficient to address the identified risks, the Council has other tools that it may use, including publicly issuing nonbinding recommendations to the primary regulators and entity designation.

Leveraged Lending

The Federal Reserve recently issued its Financial Stability Report noting that, "borrowing by businesses is historically high relative to gross domestic product (GDP), with the most rapid increases in debt concentrated among the riskiest firms amid signs of deteriorating credit standards." 2.6 Additionally, the ratio of debt to assets among publicly traded, nonfinancial firms is near a 20-year high, and the share of new loans going to the most indebted companies is near peaks reached in 2014 and just before the 2007 to 2009 financial crisis. Acknowledging this emerging risk, on February 25, 2019, the Federal Reserve, OCC and FDIC jointly responded to a letter from Sen. Warren, stating, "The leveraged loan market continues to warrant attention." They described that "while underwriting and risk management practices generally have improved in agency supervised institutions, more recently Agency examiners have observed in some transactions fewer and less stringent protective covenants, more liberal repayment terms, and incremental debt provisions that allow for increased debt that may inhibit deleveraging capacity and dilute repayment to senior secured creditors."

57. Comptroller Otting, is there more information bank regulators like the OCC can gather about leveraged lending before banks securitize them or sell them off to nonbank entities?

Response: The OCC evaluates banks' leveraged lending practices, including origination and distribution activities, through its supervisory activities. These activities include the gathering and review of appropriate information at banks that originate and/or distribute leveraged loans, including banks that agent large syndicated leveraged loans identified through the Interagency Shared National Credit program. The OCC expects banks to define and operate within acceptable risk limits and tolerances that are specific to each bank. If a bank's business model involves originating, selling, or securitizing leveraged loans, the OCC will focus its supervisory activities and information requests to reflect the level of risk posed by such activities.

Office of the Comptroller of the Currency

Washington, DC 20219

December 21, 2018

Mr. Michael E. Clements
Director, Financial Markets and Community Investment
U. S. Government Accountability Office
Washington, DC 20548

Dear Mr. Clements:

Thank you for providing the Office of the Comptroller of the Currency (OCC) an opportunity to review the Government Accountability Office's (GAO) draft report titled "Large Bank Supervision: OCC Could Better Address Risk of Regulatory Capture" (Report).

The GAO, in its review, addresses some of OCC's processes and procedures to mitigate the risk of regulatory capture, and in its findings, identifies a number of activities that in the GAO's opinion may improve documentation on these matters. We appreciate the challenge involved in trying to measure the risk of regulatory capture, and we understand the natural tendency in the face of such a challenge to focus on documentation. We agree that documentation can be improved on some matters, and we have already taken steps to implement a number of GAO's recommendations. However, we disagree that these documentation concerns increase the risk of regulatory capture. While the OCC remains fully committed to promoting vigilant supervision and independence, we are not convinced that a majority of the recommendations are necessary and advance this aim. We address these concerns below in our response to each of the nine recommendations.

Recommendation 1

The Report recommends the Senior Deputy Comptroller for Large Bank Supervision revise Large Bank Supervision's policy to require documentation of examination teams' internal deliberations that lead to consequential decisions for the bank, such as the decision to issue a Matter Requiring Attention, among others.

OCC Response

The OCC is not prepared to implement this recommendation. As noted in your report, the supervisory conclusions of individual examiners are recorded in their workpapers and conclusion memos. Preserving those documents provides transparency around when a lead examiner, a team lead, or an examiner-in-charge concludes that a different supervisory outcome is appropriate, including whether an MRA should be issued. The conclusions reached as a result of internal deliberation and consequential decisions are fully explained in communications to the bank.

The ongoing nature of supervision of large banks results in a significant amount of dialogue among OCC staff and between OCC staff and bank management. Spending time documenting those discussions versus the conclusions reached from those discussions would be extremely time consuming, would not enhance the quality of supervision, and would result in the OCC being able to conduct fewer supervisory activities or needing to significantly reduce the scope of supervisory activities. Additionally, documenting deliberations in this manner would result in staff being less likely to share their opinions, thoughts, and perspective.

Recommendation 2

The Report recommends the Senior Deputy Comptroller for Large Bank Supervision revise Large Bank Supervision's policy to require that bank examination teams retain drafts of key documents, including the conclusion memo and supervisory letter that document the supervisory review process.

OCC Response

The OCC is not prepared to implement this recommendation. The risk of regulatory capture is controlled through subjecting supervisory decisions to multiple levels of review and quality management. Examiners do not work in isolation and their internal consultations and discussions with subject matter experts, peers, and managers provides effective credible challenge and confirmation that conclusions are defensible and supported by factual evidence. Retaining early drafts of conclusion memos and supervisory letters that might not have fully informed conclusions serves little purpose. Initial impressions or early assessments of a bank's process or practice often change as examiners gather more facts and develop their analyses over the course of a supervisory activity and with benefit of consultations with and feedback from other members of the team, the EIC, and when warranted, a Deputy Comptroller. Should examiners have concerns regarding the integrity of supervisory matters, established processes exist for having those concerns investigated internally through the OCC's Ombudsman as noted in your report, or by the Treasury OIG.

Additionally, it is very important that OCC staff be able to efficiently and effectively retrieve pertinent supervisory information. Keeping extraneous information is counterproductive in that regard.

Recommendation 3

The Report recommends the Senior Deputy Comptroller for Large Bank Supervision revise Large Bank Supervision's policy to require documentation of communications with banks, including those between executive and senior management and banks that inform decisions.

OCC Response

The OCC is not prepared to implement this recommendation. We cannot conclude that extensive documentation of conversations and taking minutes from meetings would improve supervision or

that without such, examiners and management are not considering pertinent information when reaching supervisory conclusions. As described earlier, the ongoing nature of large bank supervision would necessitate almost constant pauses from and reduce time and resources dedicated to mission critical research, analysis, and internal consultation amongst peers and with supervisors to record daily banker interactions. Suggesting that no records exist of significant events would also not be correct. It is not uncommon for individual examiner conclusion memos to refer to discussions or statements made by bank staff and management as part of their support for a supervisory assessment. The influence of meetings and interactions with bankers and other parties during the course of supervisory activities is reflected in the supervisory decisions and conclusions reached and documented in supervisory activity procedures, conclusion memos, supervisory letters, reports of examination, and when applicable, in enforcement actions.

Recommendation 4

The Report recommends the Senior Deputy Comptroller for Large Bank Supervision systematically track and monitor LBS's use of informal recommendations.

OCC Response

The OCC is not prepared to implement this recommendation. This review and our independent Enterprise Governance reviews did not identify instances of inappropriate use of recommendations. This is attributable to OCC policies regarding the use of Matters Requiring Attention as the means to communicate actions a bank must take or changes that must be made. The policy is clear, enforced through training, and reinforced through review of supervisory work products at multiple points in the supervisory process. This same multi-step review process results in clear definition of actions or changes a bank must implement versus recommendations that are optional enhancements bankers might consider, if they find them useful.

Examiners make informal recommendations for bank policies that are already acceptable or for products or services that are already satisfactorily governed, constructed, and delivered to customers fairly in compliance with rules and regulations. Recommendations are not used to convey actions or changes that absent a bank taking an action or making a change would result in a bank policy, practice, product, or service that is unsafe or unsound, unfair to customers, or, in noncompliance with a law, rule or regulation. Therefore, there is no expectation that a bank implement a recommendation.

Because there is no expectation that a bank implement a recommendation and the suggested enhancement is not an action or change that affects bank safety and soundness, prudent risk management, or compliance with law, rule or regulation, tracking and monitoring recommendations is not appropriate or beneficial. In fact, it would be counterproductive as it would detract resources from the mission critical work that examiners perform - assessing large bank financial health, risk governance, compliance with laws, rules and regulations, and corrective actions required by MRAs to address concerns with a bank's practices.

Recommendation 5

GAO recommends 1) documenting the reasons for a modification to the standard scope of recusals on the annual financial disclosure form, and 2) recording waivers of supplemental standards separately from recusals.

OCC Response

The reasons for a modification from the standard practice in the scope of a recusal are often evident to an ethics reviewer from the information disclosed on the form itself and sometimes may also be documented in a separate email exchange between the ethics official and employee. It is also important to note that these modifications in the scope of a recusal are not waivers of the recusal requirement itself and reflect permissible judgments on the scope of a recusal to address potential appearance issues. Also, it would not be correct to conclude from this documentation issue or from any of the documentation issues noted in GAO's report that the OCC is somehow not collecting key conflict of interest data. We do not understand how GAO arrived at this conclusion. This ignores the extensive information the OCC collects and reviews every year on employees' interests and relationships during its financial disclosure process, a required reporting process that is far more detailed and specific with respect to banking interests and relationships than the standard Executive Branch financial disclosure process. That said, we recognize and concur in the value of further documenting reasons for an adjustment to the scope of a recusal on the annual financial disclosure form, and the Acting Chief Counsel has instructed all ethics officials to do so.

With respect to GAO's other recommendation about recording waivers of supplemental standards separately from recusals, the OCC ethics office has already been recording waiver determinations separately from recusals. GAO's concern pertains to data captured and stored in an electronic system that is being phased out and that will be retired next year. This system, known as the Ethics Tracking System, relied on manual data entry for tracking recusals and recusals/waivers. This manual data entry resulted in inconsistencies over the years in how these recusal determinations were classified, but nonetheless served one of its primary functions of showing an employee's recusals, whether or not such recusals were associated with a waiver of the OCC's supplemental ethics standards. Since 2015, all determinations on waivers of OCC's supplemental ethics regulations have been and continue to be documented via email to the headquarters ethics official. Starting next fall, the OCC's new ethics management system will be on line and will allow for capability to record and retrieve waivers of supplemental standards separately from recusals.

Recommendation 6

GAO recommends developing a policy for Large Bank Supervision to check employees' active conflict of interests during the staffing process for examinations and other supervisory activities and for documenting the results of this check.

OCC Response

The OCC is not prepared to implement this recommendation. In making this recommendation, GAO is shifting responsibility for ensuring compliance with recusal requirements from employees to personnel managing the exam staffing process. Such a shift runs the risk of undermining the expectations of personal responsibility that serves as the core of a government ethics program and a vigilant supervision program. Each year we train all employees on the government ethics standards, and we reiterate to employees – and will continue to do so – that they are responsible for upholding and adhering to Executive Branch ethics standards, which includes complying with their recusal requirements as well as all other government ethics obligations. And, we inform employees of the significant consequences, such as a criminal prosecution, that could result from their failure to do so. We believe fostering an expectation of personal responsibility will better ensure dedicated and engaged public servants.

Recommendation 7

GAO recommends updating the OCC instructions on workpaper reviews and disseminating these instructions to employees.

OCC Response

We agree and are in the process of updating the instructions, which we will disseminate next year to OCC employees. In the meantime, we are also sending out an agency-wide reminder to employees of the process and will include a copy of the OCC workpaper review form, which, as GAO noted, is available to all employees on the OCCnet.

Recommendation 8

GAO recommends conducting a periodic self-assessment of the ethics program and documenting the results.

OCC Response

We disagree with any suggestion that the OCC ethics program has not been reviewed or that the OCC is not assessing this program. GAO's analysis is largely based on a selective reading of the facts. It emphasizes a five-year old report by Treasury's Office of Inspector General about a required notification commonly handled by Human Resources, which was corrected in 2013, while minimizing the Department of Treasury's 2014 report on the OCC's ethics program, which states that Treasury's "review indicated that the OCC ethics program is strong, demonstrating a commitment to transparency and accountability and exhibiting positive program efforts that reach beyond mere technical requirements." In addition, each year we conduct a detailed review of the agency ethics program, answering approximately 95 questions and completing a 30-page report. We submit the report to the Department of the Treasury's Ethics Office as part of the annual ethics questionnaire report to the Office of Government Ethics. This is in addition to the OCC management reports GAO noted in its review, as well as the periodic reports from district ethics offices to the headquarters ethics office regarding financial disclosure filing numbers, IG

referrals, impartiality determinations, and waiver determinations. Although we have not previously documented written findings from these periodic reports, we will, in line with GAO's recommendation, formalize this process and do so going forward. Also, as previously planned, the new ethics management system will offer the headquarters ethics office greater ability to retrieve district ethics determinations and aggregate ethics information to verify information reported, which will further enhance the periodic reviews. Finally, the OCC headquarters ethics office has initiated a self-evaluation of the ethics program, patterned on the questions OGE typically requests in its review, and expects this review will be completed next month.

Recommendation 9

GAO recommends that the OCC expand its approach to addressing the risk of regulatory capture, including (1) revising its risk appetite statement to address risk areas other than reputational risk and (2) identifying additional factors to analyze when assessing the risk of regulatory capture.

OCC Response

It is neither accurate nor fair to characterize the OCC's approach to regulatory capture as limited to reputational risk. GAO's findings and recommendation on this matter overlook OCC's consideration of regulatory capture in seven of the nine defined risk categories in the OCC risk appetite statement. First, within the categories of Supervision Risk, Operational Risk, Reputation Risk, and Legal Risk, regulatory capture is considered within the element of employee conduct since regulatory capture is an employee conduct and integrity issue. Second, within the category of Supervision Risk, regulatory capture is considered within the element of lack of supervisory objectivity, critical thinking and sound judgement. Third, within the category of Legal Risk, regulatory capture is considered within the element that addresses gaps in mission critical functions and noncompliance with laws. Fourth, within the category of Human Capital Risk, regulatory capture is considered within the element of noncompliance with human capital law, rule, regulation, policy or procedure, or other matters that could compromise the agency's integrity. The OCC's 2018 Risk Appetite Statement states that the OCC has a low-risk appetite for these specific elements within Supervision, Operational, Reputation, Legal, and Human Capital Risk, and that the OCC will proactively manage and control these risks and will respond expediently should they surface. Finally, Reputation Risk also considers OCC culture from both external and internal views of OCC vision, mission, values and behaviors.

While we are unsure why these categories and elements were not addressed in GAO's review, we will evaluate whether it would be helpful to add language to our risk category definitions to make the above points more explicit.

We appreciate the opportunity to comment on the Report. If you need additional information, please contact Senior Deputy Comptroller Morris Morgan, at (202) 649-6787.

Sincerely,

Morris R. Morgan

Morris R. Morgan
Senior Deputy Comptroller for Large Bank Supervision

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CONFERENCE OF STATE BANK SUPERVISORS, Plaintiff, v. OFFICE OF THE COMPTROLLER OF THE CURRENCY, and JOSEPH M. OTTING, in his official capacity as Comptroller of the Currency, Defendants.	Civil Action No. 1:18-CV-02449 (DLF)

DEFENDANTS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS FOR LACK OF JURISDICTION AND FOR FAILURE TO STATE A CLAIM

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INTRODUCTION

The essential legal question raised by Plaintiff Conference of State Bank Supervisors ("CSBS") presents a narrow issue of statutory construction: whether the National Bank Act authorizes the Office of the Comptroller of the Currency ("OCC") to issue a national bank charter to companies that pay checks or lend money, but do not take deposits (hereinafter, "Special Purpose National Bank Charter" or "SPNB Charter"). The OCC—and, one may safely presume, CSBS—acknowledges that an authoritative resolution of this question would benefit the parties and the banking industry as a whole. But the Court's ability to resolve this dispute—and the statutory interpretation issue that underlies it—must wait. For the second straight year, CSBS has acted prematurely and has once again filed a lawsuit that should be dismissed due to lack of standing pursuant to Federal Rule of Civil Procedure 12(b)(1). At the present time, the OCC has not approved any application for an SPNB Charter, the regulatory milestone that the Court held must first be reached before CSBS has standing to sue. *See CSBS v. OCC*, 313 F. Supp. 3d 285 (D.D.C. 2018) ("*CSBS I*").

Looking past this clear jurisdictional bar, the issue of whether the Comptroller of the Currency may reasonably construe the National Bank Act fits within a much broader historic legacy of the OCC adapting to address the evolution of the industry that it regulates. Courts have accorded the Comptroller of the Currency the necessary and appropriate level of flexibility in the interpretation of the OCC's authority "to permit the use of new ways [to] conduc[t] the very old business of banking." *M&M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977). Many services or products that we now take for granted, such as ATMs, remote check capture, and online banking, were at one time cutting-edge advances. Innovation in the banking industry is inevitable, and "[t]he federal banking system must adapt to the rapid

technological changes taking place in the financial services industry to remain relevant and vibrant and to meet the evolving needs of the consumers, businesses, and communities it serves."[1]

The OCC respectfully submits that, at such time as the Court has jurisdiction to reach the merits, the Court should conclude that the OCC's longstanding special purpose bank chartering regulation, 12 C.F.R. § 5.20(e)(1), is a reasonable construction of the National Bank Act that is entitled to *Chevron* deference. The conclusion that a national bank need only be engaged in one of the three core banking functions—receiving deposits, paying checks, *or* lending money—in order to be engaged in the "business of banking" aligns with the context and structure of the National Bank Act and controlling Supreme Court and D.C. Circuit caselaw. CSBS's other arguments based upon the Administrative Procedure Act ("APA") and the Tenth Amendment are similarly without force. Therefore, CSBS's claims should be appropriately dismissed under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted.

BACKGROUND

I. OCC CHARTERING AUTHORITY AND LIMITED PURPOSE NATIONAL BANKS

The OCC is an independent bureau of the U.S. Department of the Treasury, with primary supervisory responsibility over national banks under the National Bank Act of 1864, codified at 12 U.S.C. § 1 *et seq.*, as amended. The OCC is charged with the responsibility of ensuring that national banks (and other institutions subject to its jurisdiction) operate in a safe and sound

[1] OFFICE OF THE COMPTROLLER OF THE CURRENCY, POLICY STATEMENT ON FINANCIAL TECHNOLOGY COMPANIES ELIGIBILITY TO APPLY FOR NATIONAL BANK CHARTERS (2018) ("Policy Statement"), attached hereto as Exhibit A.

manner, comply with applicable laws and regulations, offer fair access to financial services, and provide fair treatment of customers. *Id.* § 1(a). As the agency with the authority to charter national banks, a key part of the OCC's mission includes receiving applications and, when appropriate, granting charters to associations that are formed to carry out the "business of banking." *See id.* §§ 21, 26, 27. In implementing the OCC's chartering authority, "the Comptroller of the Currency is authorized to prescribe rules and regulations to carry out the responsibilities of the office." *Id.* § 93a.

Under the National Bank Act, the OCC may grant a charter "[i]f . . . it appears that such association is lawfully entitled to commence the business of banking." 12 U.S.C. § 27(a). Reflecting the variety of ways an association seeking a charter can engage in the "business of banking," national banks may be chartered to carry out differing activities. New banks may be chartered to carry out a full complement of the powers accorded to national banks under the National Bank Act or they may seek authority for more focused "special purpose" operations, such as those of trust banks, credit card banks, bankers' banks, community development banks, cash management banks, and other business models based on limited activities.[2] In some instances, such as the limited purpose charter granted to trust banks, 12 U.S.C. § 27(a), Congress has expressly recognized and ratified the OCC's authority to grant a limited purpose national bank charter. In other instances, the OCC properly relies upon its broad discretion to interpret the National Bank Act in order to determine whether a particular set of banking activities is consistent with the statutory meaning of being engaged in the "business of banking" for the purpose of granting a limited or special purpose charter.

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[2] OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S LICENSING MANUAL, CHARTERS 1 (2016) ("Charters Booklet"), https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf (last accessed Jan. 3, 2019).

Fifteen years ago, the OCC adopted the current version of its regulation that sets forth the OCC's authority to grant a national bank charter to an institution that is engaged in some, but not all, of the core banking functions. 68 Fed. Reg. 70122 (Dec. 17, 2003). This regulation provides that the OCC may charter a "special purpose bank" that conducts activities other than fiduciary activities if it engages in at least one "core banking function"—receiving deposits, paying checks, or lending money. The regulation states:

> The OCC charters a national bank under the authority of the National Bank Act of 1864, as amended, 12 U.S.C. 1 *et seq*. The bank may be a special purpose bank that limits its activities to fiduciary activities or to any other activities within the business of banking. A special purpose bank that conducts activities other than fiduciary activities must conduct at least one of the following three core banking functions: Receiving deposits; paying checks; or lending money.

12 C.F.R. § 5.20(e)(1). Since its adoption, the OCC has not used 12 C.F.R. § 5.20(e)(1) to charter a national bank that engages in one of the two core banking activities of paying checks or lending money, but does not take deposits. *See* Declaration of Stephen A. Lybarger, Deputy Comptroller for Licensing, Office of the Comptroller of the Currency, in Support of the OCC's Motion to Dismiss ("Lybarger Decl."), at ¶ 7, attached hereto as Exhibit B.

II. THE OCC'S FINTECH INITIATIVE

On July 31, 2018, the OCC announced that it would start accepting applications from financial technology companies ("fintechs") for special purpose bank charters for national banks that engage in one of the two core banking activities of paying checks or lending money, but do not take deposits. *See Press Release, Office of the Comptroller of the Currency, The OCC Begins Accepting National Bank Charter Applications from Financial Technology Companies* (July 31, 2018) ("July 31 Announcement"), attached hereto as Exhibit C. The OCC's application of its established chartering authority to grant special purpose bank charters in the fintech area emerged out of an initiative launched in 2015 by former Comptroller of the Currency Thomas J.

Curry. This initiative examined the broader question of how the OCC could best support responsible innovation in the financial services industry. In December 2016, the OCC published a white paper on the topic, *Exploring Special Purpose National Bank Charters for Fintech Companies*.[3] The OCC solicited comments on its white paper and, after reviewing the comments that it received, the agency issued the *Comptroller's Licensing Manual Draft Supplement*[4] in March 2017, again inviting public comment.

The OCC's July 31 Announcement coincided with a report issued by the Department of the Treasury ("Treasury Report")[5] that expressed strong support for the OCC's efforts in the fintech area. The Treasury Report noted the advantages to the OCC's SPNB Charter, concluding that it "may provide a more efficient, and at least a more standardized, regulatory regime than the state-based regime in which [fintech companies] operate." Treasury Report at 70. The Department of Treasury recommended that "the OCC move forward with prudent and carefully considered applications for special purpose national bank charters." *Id.* at 73, 201.

The OCC's July 31 Announcement was accompanied by a finalized version of the *Comptroller's Licensing Manual Supplement, Considering Charter Applications from Financial*

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[3] OFFICE OF THE COMPTROLLER OF THE CURRENCY, EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES (2016), https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf (last accessed Jan. 3, 2019).

[4] OFFICE OF THE COMPTROLLER OF THE CURRENCY, EVALUATING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES (2017), https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf (last accessed Jan. 3, 2019).

[5] U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES – NONBANK FINANCIALS, FINTECH, AND INNOVATION (2018), https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf (last accessed Jan. 3, 2019).

Technology Companies ("Licensing Manual Supplement"), attached hereto as Exhibit D, as well as a statement of OCC policy, *Policy Statement on Financial Technology Companies Eligibility to Apply for National Bank Charters* ("Policy Statement"), *see* Exhibit A, that enunciates the OCC's regulatory approach and expectations associated with SPNB Charters.

III. PRIOR LITIGATION BROUGHT BY CSBS

This case represents CSBS's second attempt to challenge the OCC's SPNB chartering authority in this forum. On April 30, 2018, the Court dismissed CSBS's first challenge for lack of constitutional standing as well as lack of prudential ripeness. *See CSBS I*, 313 F. Supp. 3d at 299-300. The Court noted that in the case of representational standing, as asserted by CSBS, there is a "baseline requirement to identify a particular member of the organization that was injured." *Id.* at 299. The Court concluded that neither CSBS nor its members would suffer any cognizable harm until the OCC grants final approval for an SPNB Charter. *Id.* at 299-300.

The Court only needed "to reach the first requirement [for establishing standing]—injury in fact—to resolve this case." *Id.* at 295. The Court noted that Supreme Court authority emphasized that threatened injury must be "certainly impending to constitute injury in fact, and that allegations of possible future injury are not sufficient." *Id.* (citation omitted). Against this standard, the Court reviewed CSBS's allegations of threatened injury: "risks to traditional areas of state concern," "disrupt[ion]" of the system of "dual bank enforcement," obstruction of state enforcement and regulation abilities, and threats to state sovereign interests. *Id.* at 296. The Court characterized CSBS's allegations as "filled with speculative and conclusive language." *Id.* The Court further acknowledged that the averred harms might state an injury in fact once realized, but noted that "each of those harms is contingent on whether the OCC charters a Fintech." *Id.* (citing to a similar observation by the district court for the Southern District of

New York in the related case *Vullo v. OCC*, No. 17 Civ. 3574, 2017 WL 6512245, at *7-8 (S.D.N.Y. Dec. 12, 2017)). The Court also observed that

> [s]everal contingent and speculative events must occur before the OCC charters a Fintech: (1) the OCC must decide to finalize a procedure for handling those applications; (2) a Fintech company must choose to apply for a charter; (3) the particular Fintech must substantively satisfy regulatory requirements; and (4) the OCC must decide to grant a charter to the particular Fintech.

Id. Because the OCC had not yet decided to "grant a charter to [a] particular Fintech" this "chain of speculative events" failed to clear the bar posed by the "certainly impending" test or the alternative "substantial risk" test. *Id.* at 297.

The Court also distinguished cases where regulatory injuries like preemption may satisfy the tests because "the OCC's national bank chartering program does not conflict with state law until a charter has been issued." *Id.* at 298. In addition, even if CSBS could show that the OCC "w[as] sufficiently likely to issue a charter to some particular Fintech, the complaint would remain inadequate" because of CSBS's failure to identify which particular member of its organization had been harmed. *Id.* at 298-99.

Separately, the Court also concluded that the case was constitutionally unripe for the same reason that CSBS lacked standing, and that considerations of prudential ripeness weighed in favor of deferring adjudication. *Id.* at 299-300. "This dispute would benefit from a more concrete setting and additional percolation. In particular, this dispute will be sharpened if the OCC charters a particular Fintech—or decides to do so imminently." *Id.* at 300.

IV. AT PRESENT, THE OCC HAS NOT GRANTED AN SPNB CHARTER

While the OCC has announced that it will begin accepting applications for SPNB Charters, it has not yet approved an application for an SPNB Charter to a fintech bank that does not take deposits. *See* Lybarger Decl., Ex. B, at ¶ 7. In terms of satisfying the Court's four prerequisites for when CSBS might have standing to sue, the parties are still at stage one: "the

OCC must decide to finalize a procedure for handling those applications." *CSBS I*, 313 F. Supp. 3d at 296. To date, none of the other prerequisites have come to pass: no fintech company has submitted an application for a charter and the OCC had not decided to grant a charter. Lybarger Decl., Ex. B, at ¶¶ 6, 7.[6]

ARGUMENT

I. CSBS LACKS STANDING TO SUE

A. Issue Preclusion Bars CSBS from Re-Litigating Whether It Has Article III Standing to Sue or Whether Its Claims Are Ripe for Judicial Review

Issue preclusion prevents "successive litigation of . . . issue[s] of fact or law actually litigated and resolved" that were "essential to the prior judgment," *Taylor v. Sturgell*, 553 U.S. 880, 892 & n.5 (2008), including threshold jurisdictional issues such as standing and ripeness, *see, e.g.*, *Underwriters Nat'l Assurance Co. v. N.C. Life & Acc. & Health Ins. Guar. Ass'n*, 455 U.S. 691, 706 (1982). As discussed above, CSBS has already litigated the issue of whether, absent a grant of an SPNB Charter, CSBS has Article III standing to sue or whether their claims are prudentially ripe. The Court should conclude that CSBS cannot re-litigate the Court's holding in *CSBS I* to avoid the inevitable conclusion that CSBS's claims are *still* premature.

[6] In deciding to dismiss a claim under Rule 12(b)(1) for lack of jurisdiction, a court may consider documents outside the pleadings, including sworn declarations. *See CSBS I*, 313 F. Supp. 3d at 294; *Garnett v. Zeilinger*, 323 F. Supp. 3d 58, 64-65 (D.D.C. 2018). In deciding to dismiss a claim under Rule 12(b)(6), a court may consider (1) facts alleged in the complaint, (2) documents attached as exhibits or incorporated by reference in the complaint, and (3) matters subject to judicial notice. *See, e.g., Ahuja v. Detica Inc.*, 742 F. Supp. 2d 96, 102 (D.D.C. 2010). Defendants' Exhibits A, C, and D, are documents attached to, referred to, or relied upon in the Complaint. Defendants' Exhibit B is a sworn declaration from the OCC's Deputy Comptroller for Licensing of facts relevant to standing. Defendants' Exhibit E, is a docket sheet from the U.S. District Court for the Middle District of Florida, of which the court may take judicial notice. *See Covad Commc'ns Co. v. Bell Atl. Corp.*, 407 F.3d 1220, 1222 (D.C. Cir. 2005). Similarly, the court may take judicial notice of the official OCC materials referenced in footnotes 2, 3, 4, 5, and 7 and available on government public websites. *See, e.g., Pharm. Research & Mfrs. of Am. v. U.S. Dep't of Health & Human Servs.*, 43 F. Supp. 3d 28, 33 (D.D.C. 2014).

Although the issue preclusion doctrine contains a "curable defect" exception permitting the re-litigation of certain jurisdictional dismissals, the exception does not apply here because CSBS has not demonstrated "a material change following dismissal cur[ing] the original jurisdictional deficiency" identified in the earlier suit. *See Nat'l Ass'n of Home Builders v. Envtl. Prot. Agency*, 786 F.3d 34, 41 (D.C. Cir. 2015). CSBS attempts to avoid the force of the *CSBS I* decision—and the operation of issue preclusion—by suggesting that changed circumstances justify a different outcome, Compl. ¶¶ 7, 16, but the only change CSBS can identify is the OCC's decision to entertain applications for SPNB Charters. The Court's analysis in *CSBS I* makes clear that the decision to accept applications—the first of the four chartering-process milestones identified by the Court—does not, on its own, create an injury in fact, rendering that change immaterial to the Court's conclusion regarding standing. Therefore, issue preclusion applies to the issues reached and resolved in *CSBS I.*

B. CSBS Still Lacks Article III Standing to Sue

The Court should dismiss CSBS's Complaint because CSBS has still not satisfied Article III's case-or-controversy requirement, which necessitates that a plaintiff have standing to sue. *See Lujan v. Defs. of Wildlife*, 504 U.S. 555, 561 (1992). The "irreducible constitutional minimum" for standing contains three elements: "injury in fact," "causation," and "redressability." *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 102-03 (1998). CSBS, as the party invoking this Court's jurisdiction, bears the burden of establishing each element. *Id.* at 103-04. CSBS has not met this burden because it has not shown how the OCC's decision to accept applications for SPNB Charters has injured any particular CSBS member. Consequently, CSBS has not met its burden of showing a "concrete," "actual or imminent" injury-in-fact, and hence cannot show causation or redressability. *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 409

(2013); *see also CSBS I*, 313 F. Supp. 3d at 295. Therefore, CSBS's Complaint should be dismissed pursuant to Federal Rule of Civil Procedure 12(b)(1).

As before, none of the harms CSBS references can materialize, or even be identified with the requisite certainty, until the OCC issues a SPNB Charter and the charter recipient commences the business of banking. And although "certainly impending" threats of future injury constitute injury-in-fact for standing purposes, *Clapper*, 568 U.S. at 409, the OCC remains several steps removed from issuing any such charter, *see CSBS I*, 313 F. Supp. 3d at 296; *see also* Lybarger Decl., Ex. B, at ¶¶ 6-20. Because no charter has been issued, and because no issuance is currently imminent, CSBS's chief alleged harm—the preemption of state law—has not occurred. *Cf. West Virginia ex rel. Morrisey v. U.S. Dep't of Health & Human Servs.*, 827 F.3d 81, 84 (D.C. Cir. 2016) (explaining that even if a federal government action "created a theoretical breach of State sovereignty," states must still establish "a *concrete* injury-in-fact"). To be sure, CSBS might be able to identify an injury-in-fact once the OCC issues a final SPNB Charter, depending in part on the identity of the national bank charter recipient and where the recipient conducts business. The resulting national bank would be entitled to the protections of federal law, including the preemption of conflicting state laws, which plausibly could cause harm to one or more CSBS members. But the prospect that a hypothetical statute in a hypothetical state might be preempted because of a future OCC decision imposes no "certainly impending" or imminent harm. *See CSBS I*, 313 F. Supp. 3d at 297.

CSBS's attempts to conjure additional supposed harms to its members, Compl. ¶¶ 137-147, also lack force. Each of the alleged harms CSBS identifies are (1) speculative, and (2) predicated on a fintech's operation as a national bank, which will not occur until such time as the OCC grants final approval for an SPNB Charter. *CSBS I*, 313 F. Supp. 3d at 298 ("The OCC's

national bank chartering program does not conflict with state law until a charter has been issued."). Equally problematic, CSBS has not identified *which* of its members have been harmed. *Id.* at 298-99.

CSBS's allegations also remain insufficient to establish injury-in-fact under the "substantial risk" test. *See Clapper*, 568 U.S. at 414 n.5. This test considers costs incurred by a plaintiff to "mitigate or avoid" future harm, *id.*, but nevertheless focuses on "the ultimate alleged harm . . . as the concrete and particularized injury." *Attias v. Carefirst, Inc.*, 865 F.3d 620, 627 (D.C. Cir. 2017). CSBS has not identified any efforts to mitigate or to avoid the alleged harm. *See CSBS I*, 313 F. Supp. 3d at 297. Moreover, CSBS's claims depend on the OCC's potential regulation of future third-party applicants, meaning that CSBS must allege or show that these third-party applicants will indeed submit successful applications in a way that creates the substantial risk. *See Lujan*, 504 U.S. at 562. CSBS cannot make this showing. *See Pub. Citizen, Inc. v. Trump*, 297 F. Supp. 3d 6, 7 (D.D.C. 2018).

C. This Matter Remains Unripe for Judicial Review

Article III demands that a case be ripe for judicial review. *See Abbott Labs. v. Gardner*, 387 U.S. 136, 148 (1967). Ripeness has both constitutional and prudential aspects. *See Atl. States Legal Found. v. Envtl. Prot. Agency*, 325 F.3d 281, 284 (D.C. Cir. 2003). CSBS's claims remain both constitutionally and prudentially unripe because, as the Court emphasized in *CSBS I*, the OCC has not issued an SPNB Charter. *CSBS I*, 313 F. Supp. 3d at 300-01. First, this matter remains constitutionally unripe because CSBS does not face a sufficiently "imminent" injury in fact. *See Nat'l Treasury Emps. Union v. United States*, 101 F.3d 1423, 1427 (D.C. Cir. 1996) (noting that ripeness "shares the constitutional requirement of standing that an injury in fact be certainly impending"). CSBS has not established any such injury because the OCC remains

several stages away from actually granting an SPNB Charter. *See supra* pp. 9-11.

Second, this matter remains prudentially unripe because the OCC has not finalized its decision to issue an SPNB Charter to a particular applicant. *See Gardner*, 387 U.S. at 148-49. The prudential ripeness doctrine "protect[s] . . . agencies from judicial interference until an administrative decision has been formalized *and* its effects felt in a concrete way by the challenging parties." *Id.* (emphasis added). To that end, when evaluating prudential ripeness, courts look to two factors: the "fitness of the issues for judicial decision" and the extent to which the court's withholding of a decision will cause "hardship to the parties." *Id.* at 149.

Here, neither factor has been met because the OCC has not issued an SPNB Charter. Specifically, the issues in this dispute remain unfit for judicial review because the OCC has not "charter[ed] a particular Fintech—or decide[d] to do so imminently." *CSBS I*, 313 F. Supp. 3d at 300. The fitness prong turns on, among other things, "whether the agency's action is sufficiently final." *Atl. States Legal Found.*, 325 F.3d at 284 (quoting *Clean Air Implementation Project v. EPA*, 150 F.3d 1200, 1204 (D.C. Cir. 1998)). In this case, courts would benefit from "a more concrete setting to resolve the[se] legal disputes" by waiting until "the OCC elects to adopt and *apply* a regulatory scheme to a *particular*" applicant. *CSBS I*, 313 F. Supp. 3d at 301 (emphasis added). Otherwise, the OCC could potentially face a "new legal challenge every time [it] takes a step towards a result disfavored by" organizations like CSBS, *id.* at 301, the precise situation the ripeness doctrine is meant to prevent, *see Gardner*, 387 U.S. at 148-49.

Nor will the Court's withholding of a decision impose an "immediate and significant" hardship on the parties. *See Sec. Indus. and Fin. Mkts. Ass'n v. Commodities & Futures Trading Comm'n*, 67 F. Supp. 3d 373, 413 (D.D.C. 2014) (quoting *Devia v. Nuclear Regulatory Comm'n*, 492 F.3d 421, 427 (D.C. Cir. 2007)). Because CSBS has not suffered any actual, concrete injury,

any hardship caused by the deferral of the case would be insufficiently direct and immediate, especially when compared to the hardship the OCC would experience should "each minor step towards a potential agency policy [be] litigated one-by-one." *CSBS I*, 313 F. Supp. 3d at 301. Accordingly, this matter remains unripe for judicial review.

II. BECAUSE THE JULY 31, 2018 ANNOUNCEMENT WAS NOT A FINAL AGENCY ACTION, COUNT IV FAILS TO STATE A CLAIM OF ARBITRARY AND CAPRICIOUS ACTION UNDER THE APA

CSBS asserts in Count IV of its Complaint that the OCC failed to consider the effect of its actions on state regulatory authority, and that this purported failure rendered the OCC's action arbitrary, capricious, and an abuse of discretion under the APA. This count lacks merit. First, the Court should conclude that the true target for CSBS's challenge is not the July 31 Announcement but, rather, its interpretive core: the OCC's special purpose bank regulation, 12 C.F.R. § 5.20(e)(1). As discussed more fully below, an APA challenge to the OCC interpretive regulation, to the extent it constitutes a final agency action, would be unavailing because it was promulgated *fifteen years ago* pursuant to notice and comment rulemaking. *See* 68 Fed. Reg. 70122 (Dec. 17, 2003). Any challenge to the regulation is now time barred. *See infra* pp. 15-16.

Second, Count IV fails because only final agency actions are subject to judicial review under the APA's arbitrary and capricious standard, 5 U.S.C. §§ 704, 706, and the OCC's July 31 Announcement does not represent a final agency action within the meaning of that Act. *See Gardner*, 387 U.S. at 140. Agency action becomes "final," and hence reviewable, when it satisfies both prongs of the two-part test stated in *Bennett v. Spear*, 520 U.S. 154 (1997): the agency action must (1) "mark the consummation of the agency's decision-making process," and (2) be one "by which rights or obligations have been determined, or from which legal

consequences will flow." *Id.* at 177-78; *see also Southwest Airlines Co. v. U.S. Dep't of Transp.*, 832 F.3d 270, 275 (D.C. Cir. 2016). Neither *Bennett* requirement has been satisfied. The July 31 Announcement is not an OCC action from which "rights or obligations have been determined, or from which legal consequences will flow." *Bennett*, 520 U.S. at 178. The July 31 Announcement is a statement of general policy of the OCC's readiness to accept charter applications from fintech companies. The announcement does not control the outcome of any chartering process—the OCC's statutes, regulations, and formal policies regarding the formation of a national bank govern the final disposition of an application. As recognized in *CSBS I*, no actual legal consequences apply to CSBS's members as a result of the OCC's threshold decision to accept SPNB Charter applications. *See also Peoples Nat'l Bank v. OCC*, 362 F.3d 333 (5th Cir. 2004) (finding no reviewable final agency action when a bank challenged OCC banking bulletin limiting the scope of OCC Ombudsman review of examination ratings because the bank did not use bulletin review process). At this time, however, no such charter has been issued. Accordingly, the OCC's chartering activity "should not be reviewed by a court until it has" actually occurred "and resulted in a final agency action." *Id.* at 337.

Third, the Court should dismiss Count IV because the issuance of "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice," like the July 31 Announcement, do not require notice-and-comment rulemaking. 5 U.S.C. § 553(b)(3)(A); *see also Ass'n of Flight Attendants-CWA v. Huerta*, 785 F.3d 710, 717 (D.C. Cir. 2015) (the "most important factor" in differentiating between legislative rules and nonbinding actions such as a general statement of policy is "the actual legal effect (or lack thereof) of the agency action in question"); *Nat'l Mining Ass'n v. McCarthy*, 758 F.3d 243, 252 (D.C. Cir. 2014) ("An agency action that merely explains how the agency will enforce a statute or

regulation—in other words, how it will exercise its broad enforcement discretion or permitting discretion under some extant statute or rule—is a general statement of policy."). On July 31, 2018, the OCC announced that it will use its existing statutory authority, under its existing 2003 regulation, to accept and consider SPNB Charter applications. This announcement is not a legislative rule with legal effect binding the OCC or any other party. Therefore, the announcement is exempt from the APA notice-and-comment requirement. *See, e.g., Clarian Health West, LLC v. Hargan*, 878 F.3d 346, 356-59 (D.C. Cir. 2017) (Department of Health and Human Services' 2010 instruction manual regarding the means of calculating reimbursements for Medicare providers was a general statement of policy, concerning the implementation of a 2003 regulation on authority to reconcile payments, leaving the agency free to exercise its discretion). Finally, the APA does not require the OCC to conduct cost-benefit analysis, and CSBS fails to identify any other statute that imposes such an obligation in this instance. *See Vill. of Barrington, Ill. v. Surface Transp. Bd.*, 636 F.3d 650, 670-71 (D.C. Cir. 2011); *see also Am. Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-11 & n.30 (1981) ("When Congress has intended that an agency engage in cost-benefit analysis, it has clearly indicated such intent on the face of the statute," and has used "specific language" to express that intent). Accordingly, Count IV should be dismissed for failure to state a claim.

III. BECAUSE CSBS'S FACIAL CHALLENGE TO THE OCC'S REGULATION IS TIME-BARRED, IT SHOULD BE DISMISSED

To the extent CSBS's claims present a facial challenge to the regulation at 12 C.F.R. § 5.20(e)(1), the cause of action is time-barred by the statute of limitations applicable to civil actions against the United States and federal agencies. "Except as provided [in the Contract Disputes Act of 1978], every civil action commenced against the United States shall be barred unless the complaint is filed within six years after the right of action first accrues." 28 U.S.C.

§ 2401(a). A cause of action under the APA accrues on the date of the final agency action. *Harris v. Fed. Aviation Admin.*, 353 F.3d 1006, 1010 (D.C. Cir. 2004). "Unlike an ordinary statute of limitations, § 2401(a) is a jurisdictional condition attached to the government's waiver of sovereign immunity, and as such must be strictly construed." *Spannaus v. U.S. Dep't of Justice*, 824 F.2d 52, 55 (D.C. Cir. 1987) (citations omitted). Here, any cause of action challenging the OCC's adoption of the amendments to Section 5.20(e)(1) accrued on January 16, 2004, when the Final Rule became effective. 68 Fed. Reg. 70122 (Dec. 17, 2003). Accordingly, the time for filing a facial challenge to the regulation expired in January 2010, and the Court lacks jurisdiction over the cause of action.

IV. THE OCC HAS NOT MADE A PREEMPTION DETERMINATION WITH RESPECT TO THE SPNB CHARTER, NOR IS A DETERMINATION REQUIRED

CSBS erroneously claims under Count III that the OCC has made a preemption determination with respect to SPNBs by relying on statements made in the OCC's 2016 white paper without following the procedures required by 12 U.S.C. §§ 25b and 43. Further, CSBS argues that the OCC must make a formal determination to preempt state law, and to provide notice and opportunity to comment, within the meaning of §§ 25b and 43, before granting an SPNB Charter. *See* Compl. ¶¶ 127-130. But Count III fails to state a claim, as it is premised on a misapprehension of the operation, scope, and applicability of the cited statutes. There is no support for the proposition that § 25b imposes a mandatory duty on the Comptroller to conduct a preemption determination when chartering a national bank (or in any other circumstance).

First, nothing in the statute remotely supports CSBS's position that, as a condition of granting an SPNB Charter, the Comptroller must make a preemption determination covering all of the state consumer financial laws that could be preempted every time a new national bank is

launched and begins operations. Apart from the absurdity of such a position, the statute itself makes plain that the decision of whether (and when) the OCC will issue a formal preemption decision rests with the Comptroller. Section 25b's operative language uses the word "may"—not compulsory language such as "shall' or "must"—when it provides that a preemption determination "*may* be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law." 12 U.S.C. § 25b(b)(1)(B) (emphasis added).

Second, no preemption determination has been made by the OCC that would trigger the requirements of either §§ 25b or 43b. Neither the July 31 Announcement, Ex. C, nor the Licensing Manual Supplement, Ex. D, address preemption nor do they propose the preemption of any *particular* state laws. *See id.* § 25b(b)(1)(B) (preemption determination made on a "case-by-case basis"); § 25b(b)(3)(A) ("case-by-case basis" defined as "a determination pursuant to this section made by the Comptroller concerning the impact of a *particular* State consumer financial law on any national bank that is subject to that law, or the law of any other State with substantively equivalent terms" (emphasis added)). Similarly, the OCC's 2016 white paper discusses preemption in general terms, but does not (as is required to trigger the application of § 25b) address or even suggest the preemption of a particular state consumer financial law. Rather these statements simply restate existing law regarding the application of state laws to *all* national banks (*i.e.*, no new determination has been made).[7]

Third, § 25b's scope is limited to the preemption of State consumer financial laws. 12 U.S.C. § 25b(b)(1); *see also Office of Thrift Supervision Integration; Dodd-Frank Act*

[7] EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES, *supra* n.3, at 5 ("State law applies to a special purpose national bank in the same way and to the same extent as it applies to a full-service national bank.").

Implementation, 76 Fed. Reg. 43549, 43551 (July 21, 2011). Therefore, the statute does not apply to the OCC's chartering decision because the question of whether granting a proposed national bank will result in the preemption of any particular state consumer financial law is not relevant to the chartering process; the OCC focuses instead on the proposed institution's prospects and whether it will operate in a safe and sound manner. *See* 12 C.F.R. § 5.20(f)(1); Licensing Manual Supplement, Ex. D, p. 5. When an SPNB Charter application is filed, the only question before the OCC will be whether or not to grant the application, not whether State consumer finance laws are preempted.

CSBS's reliance on 12 U.S.C. § 43 is equally unavailing. Section 43 simply provides that whenever a "Federal banking agency" seeks to issue an "opinion letter or interpretive rule" concluding that "Federal law preempts the application to a national bank of any State law regarding community reinvestment, consumer protection, fair lending, or the establishment of intrastate branches," the agency must publish a notice in the Federal Register and seek written comments. 12 U.S.C. § 43(a); *see also New Mexico v. Capital One Bank (USA), N.A.*, 980 F. Supp. 2d 1314, 1322 (D.N.M. 2013) ("Congress has expressly recognized the OCC's power to preempt *particular* state laws by issuing opinion letters and interpretive rulings, subject to certain notice-and-comment procedures." (emphasis added)).

Again, neither the OCC's July 31 Announcement nor the Licensing Manual Supplement addresses preemption, nor do they propose the preemption of any particular state laws. Likewise, the OCC's 2016 white paper discusses preemption in general terms, but does not (as is required to trigger the application of Section 43) address or suggest the preemption of a particular state law regarding community reinvestment, consumer protection, fair lending, or the establishment of intrastate branches. The question before the OCC after receiving an SPNB

Charter application will be whether to grant or deny the application, not whether a particular state consumer protection law should be preempted. Accordingly, § 43 is inapposite.

V. ALTERNATIVELY, BECAUSE THE OCC REASONABLY INTERPRETED THE AMBIGUOUS NATIONAL BANK ACT TERM "BUSINESS OF BANKING," COUNTS I, II, AND IV SHOULD BE DISMISSED FOR FAILURE TO STATE A CLAIM

Should the Court ultimately deem it proper to reach CSBS's claims related to the OCC's statutory authority, the Complaint should be dismissed for failure to state a claim because, under the framework articulated in *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984), Section 5.20(e)(1) represents a reasonable OCC interpretation of the undefined and ambiguous statutory term "business of banking."

The Supreme Court has repeatedly applied the deferential *Chevron* framework to the OCC's interpretation of the National Bank Act. *Cuomo v. Clearing House, Ass'n, LLC*, 557 U.S. 519, 525 (2009); *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 739 (1996); *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256-57 (1995) ("*NationsBank*"); *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 403-04 (1987). The *Chevron* framework proceeds in two analytical steps. "Where a statute is clear, the agency must follow the statute." *Cuozzo Speed Tech., LLC v. Lee*, 136 S. Ct. 2131, 2142 (2016). "But where a statute leaves a 'gap' or is 'ambigu[ous],' [courts] typically interpret it as granting the agency leeway to enact rules that are reasonable in light of the text, nature, and purpose of the statute." *Id.* (citing *U.S. v. Mead Corp.*, 533 U.S. 218, 229 (2001)); *Chevron,* 467 U.S. at 843.

At the outset, CSBS's assertion that the OCC's interpretation of the National Bank Act is not entitled to *Chevron* deference because it "define[s] the scope of [the OCC's] own regulatory authority" lacks merit. *See* Compl. ¶ 126. *Chevron* recognizes that when Congress leaves a gap or an ambiguity in a statutory scheme that has been entrusted to an agency's administration,

Congress has implicitly delegated to that agency the power to reasonably fill the gap or resolve the ambiguity. *See, e.g.*, *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005). There is no *Chevron* exception for interpretive decisions involving the scope of an agency's statutory authority. *City of Arlington, Texas v. Fed. Commc'ns Comm'n*, 569 U.S. 290, 298 (2013). "The reality, laid bare, is that there is *no difference*, insofar as the validity of agency action is concerned, between an agency's exceeding the scope of its authority (its 'jurisdiction') and its exceeding authorized application of authority that it unquestionably has." *Id.* at 299; *see also Montford & Co., Inc. v. Sec. & Exch. Comm'n*, 793 F.3d 76, 82 (D.C. Cir. 2015); *Verizon v. Fed. Commc'ns Comm'n*, 740 F.3d 623, 635 (D.C. Cir. 2014).

Contrary to CSBS's assertion that the statute is unambiguous, the term "business of banking" has neither an express definition nor a plain meaning in the National Bank Act. Under *Chevron*, the OCC therefore possesses discretion in addressing that ambiguity or "gap" in the statute by enacting rules that are "reasonable in light of the text, nature, and purpose of the statute." *Cuozzo Speed Tech.*, 136 S. Ct. at 2142. Moreover, the OCC's interpretation is reasonable and entitled to deference: the OCC's interpretation is not precluded by statutory text, is supported by judicial authority—including Supreme Court and D.C. Circuit precedent—and is consistent with the text, nature, and purpose of the statute. Accordingly, Counts I, II, IV, and V should be dismissed for failure to state a claim.

A. Because the Statutory Text Has No Plain Meaning under *Chevron* Step One, the OCC Has Discretion in Reasonably Interpreting "Business of Banking"

An examination of the relevant text of the National Bank Act makes clear that, under the *Chevron* framework, the term "business of banking" is ambiguous, having no fixed meaning that precludes the OCC's interpretation set forth in Section 5.20(e)(1). Section 27, the general chartering provision, states as follows:

> If, upon a careful examination of the facts so reported, and of any other facts which may come to the knowledge of the Comptroller . . . it appears that such association is lawfully entitled to commence the business of banking, the Comptroller shall give to such association a certificate . . . that such association has complied with all the provisions required to be complied with before commencing the business of banking, and that such association is authorized to commence such business.

12 U.S.C. § 27(a). The National Bank Act does not set forth any mandatory activity[8] that must be performed in order for a bank to be engaged in the "business of banking." Indeed, the text is permissive and therefore consistent with an expansive grant of discretion to the Comptroller in assigning content to the term.

The term "business of banking" appears in several other provisions of the National Bank Act, but these references offer no definition or textual elaboration that would provide a more specific meaning of the term. *See* 12 U.S.C. § 21 ("Associations for carrying on the business of banking . . . may be formed by any number of natural persons, not less in any case than five."); § 24(Seventh) (dealing with bank powers); § 26 (stating that the requirements of "title 62 of the Revised Statutes" must "be complied with before an association shall be authorized to commence the business of banking"); § 27(b)(1) (specifying that the Comptroller of the Currency may issue a "certificate of authority to commence the business of banking" to a banker's bank). In addition, a similar term, "the general business of each national banking association" is contained in a geographic restriction in 12 U.S.C. § 81 ("The general business of each national banking association shall be transacted in the place specified in its organization certificate and in the branch or branches, if any . . . ."). Accordingly, given the undisputed absence of an express statutory definition, nothing in the National Bank Act's text expressly or

[8] Section 27 also recognizes two forms of special purpose national banks: trust banks, 12 U.S.C. § 27(a), and bankers' banks, 12 U.S.C. § 27(b)(1).

implicitly precludes the OCC's interpretation of the term "business of banking" as laid out in 12 C.F.R. § 5.20(e)(1)(i).

1. In *NationsBank*, the Supreme Court Recognized the OCC's Authority to Interpret the Ambiguous Term "Business of Banking"

These statutory references to the "business of banking" have rarely been the subject of litigation that could add interpretive meaning, with the notable exception of that in § 24(Seventh), which reference has been litigated throughout the history of the National Bank Act. *See, e.g.*, *Merchants' Nat'l Bank v. State Bank*, 77 U.S. 604 (1870) (power to certify checks); *First Nat'l Bank of Charlotte v. Nat'l Exch. Bank*, 92 U.S. 122 (1875) (power to purchase securities in the course of settling a claim); *Clement Nat'l Bank v. Vermont*, 231 U.S. 120 (1913) (power to pay state taxes on depositors' accounts); *Colo. Nat'l Bank of Denver v. Bedford*, 310 U.S. 41 (1940) (power to operate a safe deposit business); *Franklin Nat'l Bank v. New York*, 347 U.S. 373 (1954) (power to advertise). Section 24(Seventh) provides that national banks are authorized:

> To exercise . . . *all such incidental powers as shall be necessary to carry on the business of banking*; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes [and provisions limiting securities and stock sales].

12 U.S.C. § 24(Seventh) (emphasis added). The Supreme Court explicated this text definitively in *NationsBank* and recognized the Comptroller's broad discretion in defining which powers are necessary to carry on the "business of banking."

In *NationsBank*, the OCC had interpreted § 24(Seventh)'s text as permitting the Comptroller to authorize national banks to sell annuities to bank customers. *NationsBank*, 513 U.S. at 254. An insurance agents' association challenged that interpretation, arguing that the text

should instead be read to limit the scope of permissible banking powers under § 24(Seventh) to activities connected with the five statutorily enumerated powers: discounting, deposit-taking, trading in exchange and money, lending, and dealing in notes. Under the association's implicit *expressio unius est exclusio alterius* statutory-structure argument, the general authorization to "exercise . . . all such incidental powers as shall be necessary to . . . the business of banking" would have been circumscribed by the succeeding text listing specific powers. *Id.* at 256. The Supreme Court, however, expressly and emphatically rejected that argument.

First, the Court reviewed the OCC's interpretation through the framework of *Chevron* deference. *Id.* at 256-57. "As the administrator charged with supervision of the National Bank Act, see [12 U.S.C.] §§ 1, 26-27, 481, the Comptroller bears primary responsibility for surveillance of the 'business of banking' authorized by § 24 Seventh." *Id.* at 256.

> It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.

Id. at 256-57 (quoting *Clarke*, 479 U.S. at 403-04).

Applying this standard, the Court affirmed the OCC's construction of the § 24(Seventh) phrase—"incidental powers . . . necessary to carry on the business of banking"—as an independent grant of authority not limited by the specified enumerated grants of authority, *id.* at 257, thus rejecting the insurance agents' arguments to the contrary:

> We expressly hold that the 'business of banking' is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated. The exercise of the Comptroller's discretion, however, must be kept within reasonable bounds. Ventures distant from dealing in financial investment instruments—for example, operating a general travel agency—may exceed those bounds.

Id. at 258 n.2. This analysis resolved the question of whether there is a distinction between "business of banking" and "all such incidental powers as shall be necessary to carry on the business of banking." By equating § 24(Seventh)'s text with the "business of banking," *NationsBank* established that the analysis is a unitary inquiry.

NationsBank marked a watershed in construing the term "business of banking," resolving an analytical dispute that had sharply divided courts of appeals for two decades. On one side of the divide, the D.C. Circuit had prefigured *NationsBank* by rejecting a narrow interpretation of § 24(Seventh) and, instead, deferring to the "expert financial judgment" of the Comptroller. *Am. Ins. Ass'n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1988) (municipal bond insurance part of the business of banking). On the other side of the divide, two courts of appeals had adopted a more restrictive test limiting the scope of permissible powers to those related to the enumerated powers in § 24(Seventh). *See M&M Leasing Corp.*, 563 F.2d at 1382 (stating the power "must be 'convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act'") (equipment leasing); *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 431 (1st Cir. 1972) (holding the test is whether the activities were "directly related to one or another of a national bank's express powers") (travel agency not authorized). *NationsBank* rejected that test, implicitly superseding *Arnold Tours*, *M&M Leasing*, and other decisions that had relied upon them.[9] Accordingly, the reasoning of any "business of banking" decisions that preceded *NationsBank* is subject to reconsideration in light of the Supreme Court's holding.

[9] While the *NationsBank* holding displaced the test applied by *M&M Leasing, NationsBank* fully vindicated the policy observation articulated in *M&M Leasing:* "the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." *M&M Leasing Corp.*, 563 F.2d at 1382.

2. The D.C. Circuit Has Confirmed That There Are No Mandatory National Bank Powers

Just as the OCC received deference in *NationsBank* when broadly interpreting the general powers of national banks under the "business of banking," the OCC has received similar deference when it approved a charter providing for a national bank to exercise a narrow range of banking powers. *Indep. Cmty. Bankers Ass'n of S.D., Inc. v. Bd. of Governors of the Fed. Reserve Sys.*, 820 F.2d 428 (D.C. Cir. 1987) ("*ICBA v. FRB*"). Nominally a suit against the Federal Reserve Board, the *ICBA v. FRB* case focused in part on an OCC decision to issue a national bank charter that authorized the exercise of limited banking powers. The charter limited the bank's deposit-taking powers in order to comply with state-law restrictions on interstate banking made applicable by the then-current version of the Bank Holding Company Act ("BHCA"). At the time, the BHCA accorded states some control over the ability of bank holding companies to acquire a national bank outside the institution's home state. *Id.* at 430-31. South Dakota law limited the operations of such national banks, in particular the deposit-taking function, in order to protect state-chartered institutions from competition. *Id.* at 431.

Specifically, *ICBA v. FRB* focused on the OCC's issuance of a charter to a credit card national bank with curtailed powers in order to conform to the South Dakota restrictions.[10] The D.C. Circuit noted that the Comptroller's decision to charter the limited purpose bank was consistent with an earlier OCC chartering decision reflected in a Federal Reserve order, *Citicorp*, 67 Fed. Res. Bull. 181 (1981). There, the Comptroller had noted that the grant of authority to

[10] The national bank charter application at issue in *ICBA v. FRB*, while proposing the primary activity of the new bank to be credit card services, also proposed to provide limited deposit-taking, lending, and checking services to the local community to the extent permitted under state law. 820 F.2d at 439. Nothing in the opinion's reasoning indicates that the D.C. Circuit placed any weight on the existence of those nominal activities.

national banks under § 24(Seventh) is "permissive, rather than mandatory," and that a national bank "rarely contemplates engaging in the full range of permissible activities." *ICBA*, 820 F.2d. at 439. The Comptroller found that the decision to operate as a limited service bank so as to avoid conflict with a state statute was "a business decision." *Id.*

Like CSBS, ICBA argued that there is "no such institution as a 'special purpose' national bank," and that a limited national bank charter was otherwise inconsistent with federal law. *Id.* at 438-40. The D.C. Circuit rejected those arguments and held that there are no "mandatory" national bank powers and that the Comptroller has the discretion to grant a national bank charter with limited powers:

> We have no doubt but that the Comptroller's construction and application of the National Bank Act in this context is reasonable. There is nothing in the language or legislative history of the National Bank Act that indicates congressional intent that the authorized activities for nationally chartered banks be mandatory. Restriction of a national bank's activities to less than the full scope of statutory authority conflicts with the purposes of the Act only if it undermines the safety and soundness of the bank or interferes with the bank's ability to fulfill its statutory obligations. That judgment requires consideration of the particular legal and business circumstances of the individual banks—a judgment within the particular expertise of the Comptroller and reserved to his chartering authority.

Id. at 440. Accordingly, the *ICBA* court's reasoning supports the OCC's authority to promulgate Section 5.20(e)(1) and illustrates that the legal concept of a special purpose national bank charter is not novel or unprecedented, but rather follows a decades-old OCC practice.

Shortly after *ICBA* was decided, Congress amended the BHCA to create an exception from the definition of "bank" applicable to credit card banks. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (August 10, 1987), *codified at* 12 U.S.C. § 1841(c)(2)(F). Congress, however, did not amend the OCC's chartering authority—there remains no express statutory chartering authority for credit card banks in the National Bank Act.

Instead, the OCC has chartered credit card banks relying on the general statutory authority endorsed in *ICBA v. FRB.*

B. Under *Chevron* Step II, the OCC Reasonably Interpreted the Statutory Term "Business of Banking" by Reference to Three Core Banking Functions Identified in the National Bank Act

In its Complaint, CSBS frames its objection to Section 5.20(e)(1) by arguing that the OCC has attempted to use the rule to expand its chartering authority beyond that delegated by statute. Compl. ¶ 155. To the contrary, case law supports the reasonable choices made by the OCC in interpreting the "business of banking" in the manner reflected by the regulation in its current form. In considering the 2003 amendment of Section 5.20(e)(1), *see supra* pp. 4, 15-16, the OCC weighed the ways in which to give content to the statutory term "business of banking" in determining eligibility for a national bank charter. The OCC's Final Rule provides that "[a] special purpose bank that conducts activities other than fiduciary activities must conduct at least one of the following three core banking functions: [r]eceiving deposits; paying checks; or lending money." 12 C.F.R. § 5.20(e)(1).

In the preamble to the Final Rule that promulgated amendments to 12 C.F.R. § 5.20(e)(1) in 2003, the OCC explained that it added the "core banking functions" requirement by reference to 12 U.S.C. § 36, which defines a national bank "branch" as a branch place of business "at which deposits are received, or checks paid, or money lent." 12 U.S.C. § 36(j). While § 36 does not include the term "business of banking," the OCC took guidance from a Supreme Court decision construing the statutory phrase the "general business of each national banking association" in 12 U.S.C. § 81 by reference to the core activities of § 36. *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 389 (1987) ("*Clarke v. SIA*"). Section 81 restricts the locations at which a national bank may conduct business: "The *general business of each national banking association*

shall be transacted in the place specified in its organization certificate and in the branch or branches, if any, established or maintained by it in accordance with the provisions of [12 U.S.C. § 36]." 12 U.S.C. § 81 (emphasis added). In *Clarke v. SIA*, the Supreme Court deferred to the OCC's reasonable interpretation of what constitutes the "general business" of each bank. Because of the close textural resemblance of the "business of banking" to the concept of the "general business" of a bank, the OCC drew on its prior analysis regarding "core activities" under § 36 to inform its interpretation of the OCC's chartering authority in § 27.

In *Clarke v. SIA*, the OCC had approved a national bank's application to offer discount brokerage services at, *inter alia*, non-branch locations both inside and outside the bank's home state. A securities trade association challenged the OCC's approval, arguing that § 81's reference to the "general business" of each banking association should be read more broadly than the § 36 activities and should include all activities statutorily authorized for national banks, including the sale of securities, which would therefore limit where such sales could be conducted. *Clarke*, 479 U.S. at 406. The Supreme Court rejected that argument. The Court found that the phrase "the general business of each national banking association" is ambiguous and held that the Comptroller's interpretation was entitled to deference. *Id.* at 403-04. The Court also observed that national banks engage in many activities, and there was no evidence that Congress intended all of those activities to be subject to the geographical limitations of §§ 81 and 36. *Id.* at 406-09. Instead, the Court found the OCC's conclusion was reasonable that the general business of the bank under § 81 included only "core banking functions," and not all incidental services that national banks are authorized to provide. *Id.* at 409. The Court also held that the OCC reasonably equated "core banking functions" with the activities identified in § 36,

which defined "branch" as any place "at which deposits are received, or checks paid, or money lent." *Id.*

The Court's endorsement of the OCC's analysis—that national banks engage in many activities, but that only these three activities represent "core banking functions" and so define the "general business" of the bank—supports treating any one of these same three activities as the required core activity for purposes of the chartering provisions. Just as the "general business" of each national bank is undefined in the location restriction of § 81, the "business of banking" is undefined in the chartering provisions of §§ 21 and 27(a). The natural reading of the two phrases is similar in meaning, which supports the reasonableness of using § 36(j) as a common source for the interpretation of each one.

Equally important, because § 36's terms are linked by "or" and not "and," performing only *one* of the activities is sufficient to meet the statutory definition and to cause the location restrictions to apply. *See First Nat'l Bank in Plant City v. Dickinson*, 396 U.S. 122, 135 (1969) (stating that because the activities element of the definition "is phrased in the disjunctive, the offering of any one of the three services . . . will provide the basis for finding that 'branch' banking is taking place"). This interpretation provides symmetry and consistency between the chartering and the location provisions of the National Bank Act.

VI. BECAUSE CSBS'S ARGUMENTS THAT THE OCC LACKS STATUTORY AND CONSTITUTIONAL AUTHORITY TO ISSUE AN SPNB CHARTER ARE MERITLESS, COUNTS I, II, IV, AND V FAIL TO STATE A CLAIM

The CSBS Complaint outlines a variety of arguments against the OCC's proposed use of Section 5.20(e)(1) to charter as a national bank an entity that does not take deposits. These arguments are predicated on CSBS's misinterpretation of the National Bank Act and rely on defunct and inapposite case law and the irrelevant requirements of statutes other than the

National Bank Act. Given the authority under the National Bank Act to grant SPNB Charters, Tenth Amendment constitutional infirmities alleged by CSBS are nonexistent, and Counts I, II, IV, and V are properly dismissed for failure to state a claim.

A. CSBS's Arguments Construing the National Bank Act Lack Merit

1. No Provision in the National Bank Act Identifies Deposit Taking as an Indispensable Function for an Association to Engage in the Business of Banking

CSBS wrongly claims that provisions of the National Bank Act pertaining to the more ministerial aspects of the chartering process—the filing of an "organization certificate" pursuant to 12 U.S.C. § 21 through § 23—give a "clear indication" that deposit taking is an indispensable function to carry on the business of banking. Compl. ¶ 68. The one thing that is clear from the statutory language cited by CSBS is that these provisions are silent as to the indispensable nature of deposit taking.

CSBS attempts to bootstrap an argument that deposit-taking is a mandatory national bank power from the unremarkable fact that the National Bank Act requires a bank's "organization certificate" to identify the place where its operations of "discount and deposit" are to be conducted. CSBS's arguments overstate the case. Part of the process of forming a new national bank includes the execution of an "organization certificate" by the bank's organizers. The certificate recites basic information, such as the name of the bank, its location, the amount of stock, and the names of initial shareholders. *See* 12 U.S.C. §§ 21-23. Section 22 states as follows:

> The persons uniting to form such an association [a National Bank] shall, under their hands, make an organization certificate, which shall specifically state: . . . [t]he place where its operations of discount and deposit are to be carried on, designating the State, Territory, or District, and the particular county, city, town, or village.

CSBS characterizes this requirement—that a bank's organization certificate supply notification designating where a bank will discount notes or take deposits—as an affirmative requirement that a bank must take deposits.

CSBS's interpretation is insupportable. Historically, the reference to operations of "discount" and "deposit" would have fixed the city where these two activities, traditionally requiring repeated retail contact with bank customers, would take place. Nothing in the language of the statue makes the discounting of notes or deposit operations mandatory. Rather, the statute simply requires the organizers to identify the place where these activities would be conducted if a particular bank engages in them. Under CSBS's logic, national banks would also be required to discount notes, an activity that banks have not undertaken in the modern era.

2. Judicial Authority and Statutory Context Defeat CSBS's *Expressio Unius* Argument

CSBS's next foray into interpreting the National Bank Act is to posit that the Comptroller's chartering authority under 12 U.S.C. § 27 is tightly circumscribed by Congress with respect to his ability to determine what it means to be engaged in the "business of banking." Without identifying the legal canon explicitly, CSBS asks the Court to apply the *expressio unius est exclusio alterius* canon of statutory construction that was rejected in *NationsBank* to conclude that because Congress specifically authorized the chartering of particular types of special purpose banks—trust banks, banker's banks, and credit card banks—it creates the inference that Congress intended to withhold the authority of the Comptroller to charter other types of special purpose banks. Compl. ¶¶ 79-85. This argument lacks merit.

Section 27's text does not reflect the structural pattern that triggers the canon's application. "As we have held repeatedly, the canon *expressio unius est exclusio alterius* does not apply to every statutory listing or grouping; it has force only when the items expressed are

members of an 'associated group or series,' justifying the inference that items not mentioned were excluded by deliberate choice, not inadvertence." *Barnhart v. Peabody Coal Co.*, 537 U.S. 149, 168 (2003); *see also U.S. v. Vonn*, 535 U.S. 55, 65 (2002). No such inference is available for § 27. The three examples CSBS cites do not present an "associated group or series." Instead, they are each manifestly different in kind: a general chartering authority, a specific chartering authority (banker's banks), and a ratification of a type of charter issued under the Comptroller's general chartering authority (trust banks).

Moreover, the timeline for the passage of each of the provisions in question establishes that the statute's present structure is not the product of a single Congress to which any intent can be attributed. Rather, the distinct provisions reflect discrete legislation by different Congresses, widely separated in time and responding to disparate reasons for legislation. The general chartering authority dates from 1864, the recognition of trust banks was added by legislation in 1978,[11] and the authority for banker's banks was added in 1982. "The possibilities either of [congressional] neglect or of implied delegation to the agency grow more likely as the contrasted contexts grow more remote from each other." *Clinchfield Coal Co. v. Fed. Mine Safety & Health Review Comm'n*, 895 F.2d 773, 779 (D.C. Cir. 1990). "[T]he canon can be overcome by 'contrary indications that adopting a particular rule or statute was probably not meant to signal any exclusion.'" *Marx v. Gen. Revenue Corp.*, 133 S. Ct. 1166, 1175 (2013) (quoting *Vonn*, 535 U.S. at 65).

[11] The trust bank text in part retroactively ratified previously issued charters. This text therefore should be read as a *post-hoc* congressional endorsement of the OCC's authority to issue special purpose charters under its general chartering authority.

Additionally, because the canon of *expressio unius* is inherently statute-specific, no meaningful inference can be drawn from the provisions of non-National Bank Act statutes such as the credit card bank exception in the BHCA heavily relied upon by CSBS. *See* 12 U.S.C. § 1841(c)(2)(F).[12] Finally, in *NationsBank*, as discussed *supra* pp. 22-24, the Supreme Court rejected an implicit *expressio unius* argument with respect to the enumerated express powers in § 24(Seventh) that, "as an associated group or series," would more plausibly satisfy the legislative pattern associated with application of the canon than does the structure of § 27.

More generally, the Supreme Court and the D.C. Circuit have repeatedly expressed caution in applying the canon, especially in an administrative context. "The *expressio unius* canon is a 'feeble helper in an administrative setting, where Congress is presumed to have left to reasonable agency discretion questions that it has not directly resolved.'" *Adirondack Med. Ctr. v. Sebelius*, 740 F.3d 692, 697 (2014) (quoting *Cheney R.R. Co. v. Interstate Commerce Comm'n*, 902 F.2d 66, 68-69 (D.C. Cir. 1990)); *see also Mobile Commc'ns Corp. of Am. v. Fed. Commc'ns Comm'n*, 77 F.3d 1399, 1404-05 (D.C. Cir. 1996) (holding that a maxim, unsupported by arguments based on the statute's structure and legislative history, was "too thin a reed" to support the conclusion that Congress had clearly resolved the issue); *Martini v. Fed. Nat'l Mortg. Ass'n*, 178 F.3d 1336, 1343 (D.C. Cir. 1999) (same). For all these reasons specific to the statutory text and structure, the doctrine of *expressio unius* is unavailing to CSBS's position.

[12] Indeed, the BHCA exception for credit card banks in 12 U.S.C. § 1841(c)(2)(F) is at odds with CSBS's theory of the case because there is no corresponding chartering authority for credit card banks in the National Bank Act. Notwithstanding the absence of any such specific National Bank Act authorization for credit card banks, the OCC has chartered such credit card banks and has been sustained in so doing. *See* discussion of *ICBA v. FRB*, *supra* pp. 25-27.

3. The Principal Cases Cited by CSBS Are Not Entitled to Weight

The Court may quickly dispose of two district court cases CSBS cites for the proposition that the OCC lacks authority to charter a limited-purpose national bank that does not take deposits. Compl. ¶¶ 80, 82. The first, *National State Bank of Elizabeth, N.J. v. Smith*, No. 76-1479, 1977 U.S. Dist. LEXIS 18184 (D.N.J. Sept. 16, 1977), was reversed by the Third Circuit. *Nat'l State Bank of Elizabeth, N.J. v. Smith*, 591 F.2d 223, 227 (3d Cir. 1979). In *Smith*, the OCC issued a charter to a national bank limited to the business of a commercial bank trust department and related activities. The district court concluded that the charter was "contrary to law and invalid," though the reasoning supporting that conclusion is unreported. *Id.* at 228. After the district court decision, and during the appeal, Congress amended 12 U.S.C. § 27(a) to recognize trust banks, retroactively and going forward. *Id.* at 231. On appeal, the Third Circuit reversed the district court, applying the terms of the newly amended § 27(a). Significantly, the Court declined to address the correctness of the district court decision when entered, and opined that the legislation had "validated the Comptroller's action." *Id.* at 231-32. Accordingly, this district court decision ceased to have any force and effect in 1979, the correctness of its reasoning was not endorsed by the Third Circuit, and therefore merits no weight in this Court.

In the second case, *Independent Bankers Ass'n of America v. Conover*, No. 84-1403-CIV-J-12, 1985 U.S. Dist. Lexis 22529 (M.D. Fla. Feb. 15, 1985) ("*Conover*"), banks and trade associations challenged the OCC's authority under § 27(a) to charter a "nonbank bank"—an institution that would either not accept demand deposits or make commercial loans, or both, so as to avoid the definition of "bank" in the BHCA and attendant restrictions on interstate operations. *Id.* at *2. In awarding the plaintiffs a preliminary injunction against final approval of a nonbank bank charter, the court characterized disapprovingly nonbank banks as taking

advantage of a statutory definition to structure themselves so as to "escape regulation" under the BHCA. *Id.* at *3. And in determining that the plaintiffs had a likelihood of success on the merits, the court looked to the "historical understanding in law and custom" of the term "business of banking." *Id.* at *23.

Like *Smith, Conover* is not good law. First, the ruling in *Conover* was an interim preliminary injunction order that was subsequently vacated when the case was dismissed before final judgment. *See* Docket Entry No. 137 (Sept. 11, 1987) (attached hereto as Exhibit E). Second, the analysis in *Conover* stands in substantial conflict with the later decision of the D.C. Circuit in *ICBA v. FRB* as to the OCC's authority to issue a limited purpose charter, *supra* pp. 25-27, and with the expansive test for "business of banking" established in *NationsBank, supra* pp. 22-24 . Third, a Supreme Court decision the year following *Conover* discounted the "intentional avoidance of regulation" justification partly relied upon in *Conover* to issue an injunction. *Bd. of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361 (1986) (rejecting Federal Reserve Board's argument that its expansive regulation was justified to prevent exploitation of statutory loopholes). Because the district court ruling never reached final judgment, because it stands in conflict with a later decision by the D.C. Circuit, and because parts of its rationale were superseded by legislation and by the Supreme Court decisions in *NationsBank* and *Dimension*, the *Conover* opinion also merits no weight in this Court.

4. No Other Authority Identified by CSBS Supports the Position that Deposit-Taking Is an Essential Function for an Association to be Chartered as a National Bank

The OCC does not dispute that deposit-taking is among the core banking functions that comprise the business of banking. *See* 12 C.F.R. § 5.20(e)(1). CSBS, however, identifies no

authority either within the National Bank Act or within other applicable law to support the proposition that a national bank *must* take deposits to be engaged in the business of banking.

CSBS's Complaint cites an OCC administrative decision approving a 1984 application from Deposit Guaranty National Bank to establish a branch in Gulfport, Mississippi. Compl. ¶ 69 (citing 1985 OCC QJ LEXIS 812). In analyzing the application, the OCC concluded unsurprisingly that a branch of a national bank that, like savings associations chartered under Mississippi law, accepted demand deposits, made commercial and other non-mortgage loans, and accepted time and savings deposits would be offering products and services that "appear to be essential to the banking business." 1985 OCC QJ LEXIS at *27. But the OCC's analysis and characterization of the scope of powers for Mississippi savings associations under state law has no bearing on assessing the minimum activities required for a financial institution to be considered carrying on the business of banking under the National Bank Act.

The remaining caselaw cited in the Complaint, ¶¶ 69, 70, 76, similarly conveys general references to the scope of the business of banking while addressing issues other than the acceptance of deposits as a necessary feature of an individual national bank. *See United States v. Phila. Nat'l Bank*, 374 U.S. 321, 326 (1963) (delineating relevant product market in banking antitrust cases); *Gutierrez v. Wells Fargo Bank, N.A.*, 704 F.3d 712, 730 (9th Cir. 2012) (dealing with preemption of state law applied to the posting of transactions for purposes of calculating overdraft fees); *Bank of Am. v. City and Cty. of S.F.*, 309 F.3d 551, 563 (9th Cir. 2002) (ruling on preemption of ordinances prohibiting banks from charging ATM fees to non-depositors); *Dep't of Banking & Consumer Fin. v. Clarke*, 809 F.2d 266, 270 (5th Cir. 1987) (overturning district court injunction against the OCC's administrative decision related to Mississippi branch application in 1985 OCC QJ LEXIS 812, and stating that "[t]he Comptroller did not incorrectly

interpret the controlling statutory provisions. His interpretation was more than a mere 'permissible construction,' all that is required in order to secure this court's deference."); *Davis v. W.J. West & Co.*, 127 Ga. 407 (1907) (individual who engaged in the money-lending business discounting notes and advertised himself as a bank, but did not take deposits and was not chartered as a bank, was not a bank).[13] These sources do not impugn the reasonableness of the OCC's interpretation of what activities are required to be deemed engaged in the business of banking under the National Bank Act or banking generally. *See supra* pp. 27-29. Indeed, the Supreme Court has recognized, near in time to the passage of the National Bank Act, that engaging in lending or payment functions is sufficient for an entity to be considered a bank. *See Oulton v. German Sav. & Loan Soc.*, 84 U.S. 109, 119 (1872) (stating that an institution is a bank "in the strictest commercial sense" if it engages in only one of the three functions of deposit taking, discounting, or circulation).

B. CSBS Improperly Invokes Statutory Provisions Outside the National Bank Act

CSBS floods its Complaint with allegations that the OCC's interpretation of the "business of banking," as used in the National Bank Act, conflicts with a host of other federal banking laws. *See* Compl. ¶¶ 67, 71-78, 125. To be clear, the OCC based its decision to accept applications for SPNB Charters solely on its interpretation of the National Bank Act, an Act over which it possesses administrative authority. *See Adams Fruit Co., Inc. v. Barrett*, 494 U.S. 638, 649 (1990) ("A precondition to deference under *Chevron* is a congressional delegation of administrative authority."). The OCC did *not* base its decision, as CSBS suggests it should, on

[13] CSBS also cites 12 U.S.C. § 378, Compl. ¶ 76, which makes it unlawful for an entity not chartered as a bank to take deposits. The statute does not establish the converse, *i.e.*, that a bank must take deposits.

statutes over which it does not possess administrative authority, both because the National Bank Act sets forth the OCC's chartering authority and because the extraneous statutory provisions cited by CSBS do not speak to the scope of that chartering authority.[14] Thus, CSBS's position—that every passage, amendment, or interpretation of a later-enacted federal banking statute requires the parallel reconsideration of existing National Bank Act interpretations—lacks both legal support and practical workability.

1. The OCC's Interpretation of the National Bank Act Does Not, and Should Not, Depend on the Bank Holding Company Act

At a loss to construct an argument based upon the National Bank Act, CSBS argues that national banks must take deposits because the BHCA classifies a "bank" as either "[a]n insured bank" as defined in Section 3(h) of the Federal Deposit Insurance Act or "[a]n institution . . . which . . . accepts demand deposits" and "is engaged in the business of making commercial loans." 12 U.S.C. § 1841(c)(1)(A)-(B). Both aspects of the definition, CSBS argues, either presume or require that an entity will take deposits in order to be considered a "bank" for BHCA purposes. Compl. ¶¶ 74-75. Governing case law, however, holds that interpretations of the National Bank Act do not depend on the terms of the BHCA.

The D.C. Circuit's decision in *Independent Insurance Agents v. Ludwig* illustrates the point. 997 F.2d 958 (D.C. Cir. 1993), *rev'd on other grounds by Indep. Ins. Agents of Am., Inc. v. Clarke*, 955 F.2d 731, 732 (D.C. Cir. 1992). There, the D.C. Circuit rejected arguments that the OCC's interpretation of Section 92 of the National Bank Act must be harmonized with a later-enacted amendment to the BHCA. *Id.* at 962. Acknowledging materials suggesting that

[14] *Cf. Am.'s Cmty. Bankers v. Fed. Deposit Ins. Corp.*, 200 F.3d 822, 833 (D.C. Cir. 2000) (stating that when an agency's interpretation "derive[s] principally from" an organic statute, "the two-step *Chevron* inquiry [remains] appropriate"); *see also Ass'n of Civilian Technicians v. Fed. Labor Relations Auth.*, 250 F.3d 778, 782 (D.C. Cir. 2001).

Congress intended the BHCA amendment to "parallel" Section 92, the D.C. Circuit nonetheless deferred to an OCC interpretation of Section 92 that directly contradicted the Federal Reserve Board staff's interpretation of the "parallel" BHCA provision. *Id.* The D.C. Circuit also reiterated the district court's conclusion that "[t]he [National Bank Act and BHCA] were enacted over sixty-five years apart and deal with two different types of banking institutions, each subject to a distinct set of laws and regulations administered by separate agencies." *Id.* (quoting *Nat'l Ass'n of Life Underwriters v. Clarke,* 736 F. Supp. 1162, 1171 (D.D.C. 1990)). The D.C. Circuit further cited to an earlier case where it rejected a similar argument suggesting that the OCC was obligated to follow the BHCA: "the Comptroller derived his authority solely under the [National Bank Act], and it was his responsibility to determine issues under that Act, not under the BHCA." *Id.* at 962 (citing *Am. Ins. Ass'n*, 865 F.2d at 287).

CSBS's reliance on *Whitney v. National Bank of New Orleans & Trust Co.* fails for related reasons. 379 U.S. 411 (1965). In that case, Whitney National Bank of New Orleans ("Whitney") planned to establish a new national bank in another parish of Louisiana. *Id.* at 413. To do so, Whitney sought approval from the Federal Reserve Board of its plan to organize itself as a bank holding company. *Id.* After the Federal Reserve Board approved the plan, Whitney's competitors filed a declaratory judgment action seeking a determination that the Comptroller of the Currency had no power to issue a certificate of authority for the new bank because of state bank branching laws made applicable by the BHCA. *Id.* The Supreme Court, however, held that the Federal Reserve Board and the OCC have distinct roles with respect to newly established national banks proposed to be owned by bank holding companies. In the Court's words, the authorization for the new national bank was "the sole function of the Comptroller, requiring his appraisal of the bank's assets, directorate, etc., and his action is therefore necessary in addition to

that of the Board approving the organization by the holding company." *Id.* at 417. Separately, the Court noted that "[t]he Bank Holding Company Act makes the Board's approval of a holding company arrangement binding upon the Comptroller." For that reason, the Comptroller could be stayed from issuing a certificate pending Federal Reserve Board action, but only in "exceptional circumstances." *Id.* at 426 n.7; *see also Am. Ins. Ass'n*, 865 F.2d at 287-88 (*per curiam* on petitions for rehearing) (declining to find such "exceptional circumstances").

In that same vein, CSBS ignores *Whitney*'s key observation that "it is the ownership of [the new bank] by the holding company that is at the heart of the project, not the permission to open for business which is acted upon routinely by the Comptroller once the authority to organize is given by the Board." *Whitney*, 379 U.S. at 423. Thus, the BHCA governs affiliations between "banks," as defined for BHCA purposes, and other companies—in particular nonfinancial commercial companies. *Id.* The BHCA does not, however, speak to the nature or type of national banks the OCC can charter—an authority governed exclusively by the National Bank Act.[15]

2. Neither the Federal Reserve Act nor the Federal Deposit Insurance Act Require National Banks to Accept Deposits and Acquire Deposit Insurance

CSBS improperly relies on provisions of the Federal Reserve Act ("FRA") and the Federal Deposit Insurance Act ("FDIA") when it argues that all nationally chartered banks must accept deposits because they are required to have federal deposit insurance. Compl. ¶¶ 71-73. When read in the proper context, nothing in these Acts require national banks to acquire deposit insurance and, by extension, to accept deposits. To be sure, the FRA states that "[e]very national

[15] Similarly, CSBS does not identify any authority where a court relied on provisions of the Federal Deposit Insurance Act to interpret terms in the National Bank Act. *Cf. In re Cmty. Bank of N. Va.*, 418 F.3d 277, 295 (3d Cir. 2005) (reading provisions of the FDIA with the aid of the National Bank Act, not the reverse); *Greenwood Tr. Co. v. Massachusetts*, 971 F.2d 818, 822 (1st Cir. 1992) (doing the same).

bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located," become a member of the Federal Reserve System and "shall thereupon be an insured bank" under the FDIA. 12 U.S.C. § 222. But the text, structure, and history of that and other related provisions demonstrate the discretionary, rather than mandatory, nature of the deposit-taking function for a given institution. Neither the FDIA nor the FRA imposes conditions on or limit the Comptroller's discretion when determining what it means to be engaged in the business of banking for purposes of the National Bank Act. Nor do the cited FDIA and FRA provisions require every national bank to take deposits or to be insured.

To demonstrate, the plain text of the current FDIA provision governing the deposit insurance application process does not impose any corresponding deposit insurance requirement for all national banks. *See* 12 U.S.C. § 1815(a)(1). Section 1815(a)(1) specifies that, absent two exceptions not relevant here, "any depository institution which is engaged in the business of receiving deposits other than trust funds . . . , upon application to and examination by the Corporation and approval by the Board of Directors, may become an insured depository institution." *Id.* The statute's language leaves open the possibility of the existence of banking institutions that would not be insured because they are not "engaged in the business of receiving deposits other than trust funds." *Id.*

A careful parsing of the statutory language bears this reasoning out. Nothing in § 1815 suggests that a non-depository institution *must* become an insured depository institution. Instead, § 1815(a)(1) applies with respect to "depository institution[s] . . . engaged in the business of receiving deposits other than trust funds" who "*may* become . . . insured depository institution[s]." *Id.* (emphasis added). Section 1815(a)(1)'s separation of "depository institution[s]" from "insured depository institution[s]" is no accident: the FDIA defines both

terms, and notes that the former "means any bank or savings association" while the latter "means any bank or savings association the deposits of which are insured." *Id.* § 1813(c)(1)-(2). Other FDIA provisions echo this distinction, and expressly envision the existence, operation, and supervision of uninsured banks. *See id.* § 1813(h) (defining "noninsured bank" for purposes of the Act); § 1818(b)(5) (noting that the OCC's authority to issue cease-and-desist orders extends "to any national banking association chartered by the Comptroller of the Currency, *including an uninsured association*" (emphasis added)).

Similarly, FDIA provisions dealing with the cessation of a national bank's insured status contemplate situations where a banking institution may operate without deposit insurance and without taking deposits. While the FDIA states that insured national member banks cannot voluntarily surrender their deposit insurance, 12 U.S.C. § 1818(a)(1), the prohibition yields when these entities stop accepting deposits other than trust funds. For example, a national bank's insured status *shall* terminate if it no longer receives deposits other than trust funds, 12 U.S.C. § 1818(p), or if another institution assumes its deposits, 12 U.S.C. § 1818(q). But these provisions do not *require* the OCC to terminate a national bank's charter if or when that bank loses its insured status because it no longer accepts deposits. Instead, these provisions show that the link between being a national bank and having deposit insurance applies only to those national banks that actually hold deposits other than trust funds.

Nor does 12 U.S.C. § 222 support CSBS's argument. Section 222 states that a national bank "shall . . . become a member of the Federal Reserve System" and, after becoming a member, "shall thereupon be an insured bank" under the FDIA. 12 U.S.C. § 222. CSBS relies on this latter phrase to argue that every national bank must be insured and, by implication, must take deposits. But when read in its proper context, the provision expresses a descriptive, rather

than prescriptive, function and purpose. Under § 222, national banks need not take any specific action to become an "insured bank." The lack of any specific mandate stands in stark contrast to the detailed requirements that § 222 instructs national banks to meet in order to become members of the Federal Reserve System. *Id.* (instructing national banks to become Federal Reserve System members by "subscribing and paying for stock in the Federal Reserve bank of its district"); *see also* 12 U.S.C. § 282 (outlining the Federal Reserve bank stock subscription process). Thus, § 222 should be read as simply conferring the status of "insured bank" on those national banks that need to obtain deposit insurance under 12 U.S.C. § 1815(a)(1), *i.e.*, on those national banks that take deposits other than trust funds.

This reading also aligns with § 222's historical role in the deposit insurance sphere. Congress added the provision at issue in contemplation of Alaska entering the Union. Pub. L. No. 85-508, § 19, 72 Stat. 339, 350 (1958). National banks located in states are required to be member banks. 12 U.S.C. § 282. National banks located in U.S. territories are not. 12 U.S.C. §§ 143, 466. Congress amended § 222 to facilitate the transition of national non-member banks in Alaska and Hawaii to the status of member banks and insured banks by virtue of, among other things, automatic eligibility for deposit insurance. *See* H.R. Rep. No. 85-624, at 2933 (1957) (noting that the enactments would "enable Alaska to achieve full equality with existing states, not only in a technical juridicial sense, but in practical economic terms as well"). Stated differently, § 222 allowed national nonmember banks in Alaska and Hawaii to become member banks—and, without further action, "insured banks"—at a time when all newly chartered national member banks engaged in the business of receiving deposits other than trust funds would have been required to be insured and been granted insurance automatically upon receiving a charter. *See* 12 U.S.C. § 1814(b) (prior to amendments by Pub. L. No. 101-73, § 205, 103 Stat.

183, 195 (1989) and Pub. L. No. 102-42, § 115(b), 105 Stat. 2236, 2249 (1991)). This automatic process, however, was modified in part by the amendments imposed by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") and the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and altered by § 1815(a)(1)'s deposit insurance application system. Accordingly, § 222 should not be read as currently imposing any deposit-insurance requirement or, more importantly, a deposit-taking requirement.

C. Neither Section 5.20(e)(1) nor Any SPNB Charter Issued in the Future Would Violate the Supremacy Clause or the Tenth Amendment

In the 153-year history of the national bank system, it has been repeatedly established that the Supremacy Clause operates in concert with the National Bank Act to displace state laws or state causes of action that conflict with federal law or that prevent or significantly interfere with national bank powers. *See, e.g., Barnett Bank of Marion Cty. v. Nelson,* 517 U.S. 25 (1996); *Franklin Nat'l Bank v. New York*, 347 U.S. 373 (1954). As a federal regulation, Section 5.20(e)(1) preempts contrary state law. *See, e.g., Smiley*, 517 U.S. at 735 (1996); *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982). Under these lines of authority, a fintech chartered as a national bank under Section 5.20(e)(1) would be entitled to the protections of the National Bank Act against state interference.

> It bears repeating that the entire legislative scheme is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of the national banks, therefore, the Comptroller has the power to preempt inconsistent state law.

CSBS v. Conover, 710 F.2d 878, 885 (D.C. Cir. 1983).

The Tenth Amendment is not implicated when the Constitution assigns authority to the federal government. "If a power is delegated to Congress in the Constitution, the Tenth

Amendment expressly disclaims any reservation of that power to the States." *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 22 (2007). "Regulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses." *Id.* Accordingly, the Tenth Amendment has no application to either Section 5.20(e)(1), or to any SPNB Charter issued in the future.

CONCLUSION

For the reasons stated above, the Complaint should be dismissed on all counts for lack of jurisdiction or, in the alternative, for failure to state a claim upon which relief can be granted.

Date: January 7, 2019

Respectfully submitted,

/s/Gregory F. Taylor

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Economic Growth Act Rulemakings in Process as of August 5, 2019

Draft for Discussion Purposes Only

	OCC-ONLY EGRRCPA RULEMAKING	
Rule	**Description**	**Status**
Election to Operate as a Covered Savings Association (Thrift Flexibility) **Section 206**	Section 206 of the EGRRCPA requires the OCC to issue rules to implement a provision that allows small federal savings associations to elect to operate as "covered savings associations" with the powers and restrictions of national banks but the corporate form of thrifts.	Final rule published 05/24/2019; effective date 07/01/2019. **COMPLETE**
	INTERAGENCY EGRRCPA RULEMAKINGS	
Rule	**Description**	**Status**
Liquidity Coverage Ratio: Treatment of Certain Municipal Obligations as Level 2B High-Quality Liquid Assets (HQLA) **Section 403**	Requires the FBAs to amend the Liquidity Coverage Ratio final rule to classify qualifying investment-grade, liquid and readily-marketable municipal securities as level 2B liquid assets.	Interim final rule published on 08/31/2018; comment period closed 10/01/2018. Final rule published 06/05/2019; effective date 07/05/2019. **COMPLETE**
Expanded Examination Cycle for Certain Small Insured Depository Institutions **Section 210**	Section 210 of the EGRRCPA expands the18-month examination schedule to qualifying well capitalized and well managed institutions with less than $3 billion in total assets.	Interim final rule published on 08/29/2018; comment period closed 10/29/2018. Final rule published 12/28/2018; effective date 01/28/2019. **COMPLETE**
Capital: High Volatility Commercial Real Estate (HVCRE) **Section 214**	Implement revisions that would limit the types of acquisition, development, and construction (ADC) loans that may be considered high volatility commercial real estate (HVCRE) exposures and subject to heightened capital requirements.	The first NPR published on 09/28/2018; comment period closed 11/27/2018. The second NPR published on 07/23/2019 and the comment period closes on 08/22/2019. Final rule expected October 2019.

Short Form Call Report NPR **Section 205**	Requires the appropriate FBAs to issue regulations to reduce reporting requirements for covered depository institutions for the first and third reports of the year. Covered depository institutions are less than $5B in assets and that meet other criteria that the FBAs determine.	Final rule published 06/21/2019; effective date 07/22/2019. **COMPLETE**
Volcker Community Bank Relief and Removing Naming Restrictions **Sections 203 and 204**	Section 203 exempts any insured depository institution from the definition of "banking entity" under the Volcker Rule if it does not have and is not controlled by a company that has (1) more than $10 billion in total consolidated assets; and (2) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5 percent of the institution's total consolidated assets. Section 204 eases Volcker Rule restrictions on common names between banks and sponsored funds.	Final rule published on 07/22/2019; effective date 07/22/2019. **COMPLETE**.
Capital: Community Bank Leverage Ratio **Section 201**	Applies to banks with less than $10 billion in assets and that meet certain other requirements. Requires the appropriate FBAs to issue a rule to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than eight percent and not more than 10 percent; and to establish procedures for treatment of a qualifying community bank that has a community bank leverage ratio that is below the percentage developed under the regulation. Banks meeting requirement will not be subject to other capital requirements.	The NPR was published on 02/08/2019; comment period closed 04/09/2019. Final rule expected September 2019.

Supplemental Leverage Ratio (SLR) for Custodial Banks **Section 402**	Requires the federal banking agencies to propose changes to the SLR denominator for custody banks specifying that funds of a custody bank that are linked to custody activities and deposited with a central bank will not be used for calculating the SLR, subject to certain limitations.	NPR published on 04/30/2019; comment period closed 07/01/2019. Final rule expected by year-end 2019.
Enhanced Supervision and Prudential Standards for Certain Bank Holding Companies (Stress Testing) **Section 401**	Requires each Federal primary regulatory agency to amend its regulations with respect to company- run stress tests for "other financial companies," including national banks and Federal savings associations. The asset threshold is raised from $10B to $250B for "other financial companies" and all of the company-run stress tests are required to be conducted periodically, rather than annually. In addition, each Federal primary regulatory agency must change the number of scenarios it must provide from 3 to 2 and eliminate the "adverse" scenario.	NPR published 02/12/2019; comment period closed on 03/14/2019. Final rule expected by year-end 2019.
Exemption from Appraisals of Real Property Located in Rural Areas **Section 103**	Provides a tailored exemption from the appraisal requirements under FIRREA for certain mortgage loans with a transaction value of less than $400,000 that are located in rural areas.	NPR published 12/07/2018 to increase the appraisal threshold for residential transactions and to incorporate the rural exemption in the appraisal rules; comment period closed 02/05/2019. Comptroller has approved the rule; FDIC Board scheduled to approve the rule on 08/20/2019. Publication of final rule expected in August 2019.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Chairwoman Waters:

Wells Fargo and Megabank Supervision, Enforcement and Accountability

In February 2018, the Federal Reserve imposed an asset cap of $1.95 trillion on Wells Fargo to address widespread consumer abuses and compliance breakdowns by the megabank until it cleans up its operations. In April 2018, the OCC issued a civil money penalty of $500 million against the bank for similar misdeeds. However, these penalties are just the cost of doing business, as Wells Fargo earned nearly $6 billion in profits the first three months of this year alone. Even the Fed's asset cap has not corrected a culture of bad behavior and mismanagement that has resulted in harm for millions of Americans. Given that the regulators' actions have not resulted in real changes at the bank, it is past time for Congress to step in. So on March 12th, the Committee invited the then-CEO of Wells Fargo, Tim Sloan, to testify before the Committee, and after a few hours of tough but fair questioning,[1] he stepped down from his position a few days later. Additionally, the Committee held a hearing with the CEOs of the other seven U.S. G-SIBs on April 10, 2019.[2] The hearing highlighted that while U.S. G-SIBs made $780 billion in profits the last 10 years, they paid at least $163.7 billion in fines for a litany of violations of law, many of which resulted in consumer harm, underscoring that fines amount to the cost of doing business and do not appear to serve as a strong enough enforcement tool to deter future abuses.

[1] https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402383
[2] https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402507

2. Vice Chairman Quarles, we learned shortly after the Committee's March hearing that the Wells Fargo Board awarded Mr. Sloan a $2 million bonus for 2018. The Fed put out a statement that, "[t]he Federal Reserve does not approve pay packages. We expect boards of directors to hold management accountable."

As you are aware, I have voluntarily recused myself from voting on, or participating by decision or recommendation in, matters specifically involving Wells Fargo. The answers below describe matters of general applicability or public record.

- **How is the Fed ensuring that boards of directors hold management accountable for violating the law?**

On occasion, the Federal Reserve has confronted situations where a financial institution's management has been unwilling or unable to address issues that present a safety and soundness concern for the institution. In these cases, the Federal Reserve may require the institution to make changes to its governance and oversight structure, establish procedures for management to escalate important issues to senior management and the Board of Directors, and to report on the steps being taken to address the supervisors' concerns to the Federal Reserve. It is the Federal Reserve's practice to formalize these requirements in our enforcement actions where the severity of the firm's misconduct warrants such action.

- **What is the Fed doing to hold boards of directors accountable when megabanks break the law?**

Federal Reserve examiners communicate the most serious deficiencies identified during supervisory activity to the board of directors or executive-level committee of the board of the organization involved. Examiners must follow up to assess the organization's progress in implementing corrective action and verifying satisfactory completion. For the largest organizations, Federal Reserve examiners will meet periodically with each organization's board of directors to discuss supervisory matters as they arise.

Where an organization's corrective action has not been satisfactory, initiation of additional informal or formal investigative or enforcement action may be taken. In many cases where an enforcement action is warranted, the board of directors must review and approve the organization's entry into the enforcement action.

Where individual members of the board of directors of an organization have engaged in serious personal misconduct, the Federal Reserve has available enforcement tools to address the individual's actions, such as a cease and desist order, civil money penalty, or removal from office, depending on the severity of the misconduct.

3. Vice Chairman Quarles, is the asset cap the Fed put in place adequate for changing Wells Fargo's behavior?

As you are aware, I have voluntarily recused myself from voting on, or participating by decision or recommendation in, matters specifically involving Wells Fargo.

- **While Mr. Sloan finally stepped down, has there been sufficient accountability of the executives responsible for these actions?**

As you are aware, I have voluntarily recused myself from voting on, or participating by decision or recommendation in, matters specifically involving Wells Fargo.

- **Has the Fed considered permanently barring Mr. Stumpf or Mr. Sloan from working in the banking industry as it has done with other executives?**

As you are aware, I have voluntarily recused myself from voting on, or participating by decision or recommendation in, matters specifically involving Wells Fargo.

- **What more can the Fed do with the authorities it has to ensure there is accountability for megabanks that repeatedly break the law?**

From a supervisory perspective, we recognize the importance of the need to ensure we are appropriately focusing supervisory resources on assessments of banking organizations' governance and controls, particularly around compliance and operational risks. This remains a priority in all our supervisory programs.

Incentive-Based Compensation

The Wells Fargo fraudulent account scandal, and its incentive-based cross-selling strategy that fueled it, is a stark reminder how important it is for financial regulators to finalize executive compensation rules. As you know, Section 956 of the Dodd-Frank Act directed the regulators to adopt joint rules aimed at prohibiting incentive compensation arrangements that could encourage inappropriate risks at financial institutions. The regulators made an initial proposal in 2011, then reworked the proposal and issued a new plan in 2016. The proposal increases in stringency based on the financial company's asset size with enhanced requirements for senior executive officers and significant risk-takers.

48. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, please provide the Committee with a timeline for each specific mandate required by S. 2155 from the 115th Congress and the Dodd-Frank Wall Street Reform and Consumer Protection Act that requires a rulemaking that your agency has yet to be finalized.

The Federal Reserve Board (Board), together with the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) (collectively, the agencies), have completed all major required regulatory actions under S.2155. The remaining outstanding proposal concerns amendments to the assessment framework for large depository institution holding companies. We expect to finalize the amendment early in 2020.

In terms of the required regulatory actions in the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Board, on its own or working on an interagency basis as required, also has completed most of the required rulemakings. Proposed rulemakings have been issued to solicit public comment on many of the remaining required rules, such as incentive compensation. I cannot provide a specific timeframe for interagency action to finalize these rules. With respect to incentive compensation, however, the Board has not waited to finalize a rule to act. The Federal Reserve continues to evaluate incentive compensation practices as a part of ongoing supervision, focusing on monitoring risk management and governance around incentive compensation practices. Additional information on the Board's regulatory actions may be found on the Unified Agenda.[2]

Financial Stability and Lessons from the Financial Crisis

51. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, earlier this week, former Fed Chairs Bernanke and Yellen, along with former Treasury Secretaries Geithner and Lew, wrote a letter to Chairman Powell and Secretary Mnuchin about a proposal by FSOC to make it much harder to designate a future AIG that poses a systemic risk to the financial system.[24] The former officials wrote, "Though framed as procedural changes, these amendments amount to a substantial weakening of the post-crisis reforms. These changes would make it impossible to prevent the buildup of risk in financial institutions whose failure would threaten the stability of the system as a whole."

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[2] See https://www.reginfo.gov/public/do/eAgendaMain.

Given these significant concerns, will FSOC reconsider its proposed guidance that would, in the words of these officials, "neuter the designation authority"?

[24] See https://www.nytimes.com/2019/05/13/us/politics/financial-regulation-trump-administration.html and https://int.nyt.com/data/documenthelper/887-bernanke-geithner-lew-yellen-letter/a22621b202dfcb0fe06e/optimized/full.pdf.

The changes proposed by the Financial Stability Oversight Council (FSOC) to the guidance on nonbank financial company determinations would promote an activities-based approach for identifying and mitigating risks to financial stability. The activities-based approach represents a framework that addresses financial stability risks by directly targeting risky activities. The public comment period on the proposed amendments closed recently and the FSOC will consider these comments in the course of making any final changes to its guidance. The FSOC has announced a meeting on December 4, and the preliminary agenda for the open session includes final interpretive guidance regarding nonbank financial company designations.

Leveraged Lending

The Federal Reserve recently issued its Financial Stability Report noting that, "borrowing by businesses is historically high relative to gross domestic product (GDP), with the most rapid increases in debt concentrated among the riskiest firms amid signs of deteriorating credit standards."[26] Additionally, the ratio of debt to assets among publicly traded, nonfinancial firms is near a 20-year high, and the share of new loans going to the most indebted companies is near peaks reached in 2014 and just before the 2007 to 2009 financial crisis. Acknowledging this emerging risk, on February 25, 2019, the Federal Reserve, OCC and FDIC jointly responded to a letter from Sen. Warren, stating, "The leveraged loan market continues to warrant attention." They described that "while underwriting and risk management practices generally have improved in agency supervised institutions, more recently Agency examiners have observed in some transactions fewer and less stringent protective covenants, more liberal repayment terms, and incremental debt provisions that allow for increased debt that may inhibit deleveraging capacity and dilute repayment to senior secured creditors."[27]

[26] https://www.federalreserve.gov/publications/files/financial-stability-report-201905.pdf
[27] https://www.forbes.com/sites/mayrarodriguezvalladares/2019/05/07/u-s-bank-regulators-acknowledge-senator-warrens-concerns-about-rapidly-growing-leverage-lending-markets/#180ba94f1533

56. Vice Chairman Quarles, what steps is the Federal Reserve taking to address these serious concerns with respect to leveraged lending? Is there a role for the Office of Financial Research to play to help gather information, especially data about activity outside of the banking system?

The Federal Reserve has examined leveraged loans held by supervised institutions for many years. The Federal Reserve continues to dedicate substantial resources to monitor these loans carefully and to closely supervise institutions with leveraged loan exposures through processes such as the Shared National Credit (SNC) review. In addition, Federal Reserve staff performs

ongoing analysis to assess and to understand the risks within the broader leveraged lending market. Our analysis has included quantifying bank holdings of leveraged loans and assessing the direct and indirect exposures of large banking institutions.

The Federal Reserve will continue to assess leveraged lending risk routinely through the supervisory process and monitor non-bank leveraged lending activity and its potential impacts. In this regard, the Federal Reserve will continue to assess the appropriateness of bank policies and procedures, risk management, controls, underwriting standards, and governance practices. Examiners will evaluate the appropriateness of a bank's aggregate exposure to leveraged loans in relation to capital, individual hold positions, industry diversification, and the associated impacts of risk layering in transactions. Examiners also will assess whether underwriting standards are aligned with a bank's risk appetite and review whether risk management practices are keeping pace with market changes. Deficient policies, procedures, or practices that relate to safety and soundness may result in supervisory action.

As I have stated above, the Federal Reserve holds banks to high risk-management standards and has a good understanding of the direct and indirect exposures of banks to leveraged loans. We are always working to improve our understanding of risks to the system, however, and this is particularly true when considering risks on a systemic or global level. For this reason, the Financial Stability Board (FSB) under my chairmanship has been reviewing global data on leveraged loan exposures to develop a more complete picture of where there may be concentrations of such exposures globally. The Federal Reserve will continue to work closely with other regulators at the FSB and the FSOC to better understand this evolving risk and develop methodologies to address them. In a domestic context, there may be some role for the Office of Financial Research to contribute to these efforts.

<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Chairwoman Maxine Waters:</u>

Deregulating Megabanks – Capital, Leverage, Stress Testing, Living Wills

Soon after President Trump assumed office, he said that, "[W]e're going to do a big number on Dodd-Frank," and he tasked the Treasury Department to design the roadmap. Treasury issued a series of reports with dozens of deregulatory recommendations to roll back capital, leverage, stress testing and other safeguards, and Secretary Mnuchin recently said he was pleased at how regulators were implementing those suggestions.

To that end, regulators have advanced several proposals to change prudential requirements for the largest banks. In April 2018, the Federal Reserve issued a set of proposals to revise its capital rules for G-SIBs and introduced a "stress capital buffer," or SCB, which would in part integrate the forward-looking stress test results with the Board's non-stress capital requirements.[4] The Federal Reserve joined the OCC in releasing a second proposal to substantially alter the current enhanced supplementary leverage ratio (eSLR) that applies to G-SIBs.[5] The FDIC estimated the eSLR proposal would lower capital requirements for the primary federally-insured bank subsidiary of each G-SIB by a combined $121 billion. In October 2018, the Federal Reserve, FDIC and OCC released proposals to implement S. 2155 that would tailor the application of prudential standards to large banks, proposing to establish four categories of large banks based on asset size and cross-border activity.[6] In March 2019, the Federal Reserve decided not to deploy the countercyclical capital buffer that would require large banks to build additional capital,[7] and made revisions to the stress-testing regime to limit the use of the "qualitative objection,"[8] which may make it easier for large banks to pass their stress tests.[9] In April, regulators proposed easing prudential standards for foreign banks,[10] and modifying large bank resolution plans (referred to as "living wills") so that for many large banks would submit plans every three years.[11]

These proposals have received a range of criticisms, including opposition from Federal Reserve Governor Lael Brainard and FDIC Board Member Marty Gruenberg.[9] Former Federal Reserve Governor Dan Tarullo described these proposals as "low-intensity deregulation,"[10] explaining these roll backs come at a cost. In a research note by Fitch Ratings, analysts noted that a proposal issued recently by the Federal Reserve and FDIC to extend the living will deadlines for G-SIBs from annual submission to every other year would be a "negative" credit event for those financial institutions, writing, "As regulatory requirements continue to ease on the margin for the largest banks, risks inherent to their complexity can be further exacerbated by the loss of comparative data from annual resolution planning and stress testing data."

[4] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.
[5] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm.
[6] https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20181031.pdf

[7] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm
[8] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm[9] Alan Rappeport and Emily Flitter, "Regulators Move to Ease Post-Crisis Oversight of Wall Street," New York Times (Mar. 6, 2019), https://www.nytimes.com/2019/03/06/business/bank-regulation.html
[10] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm
[11] https://www.fdic.gov/news/news/press/2019/pr19035.html
[12] For example, see https://www.americanbanker.com/news/the-feds-lael-brainard-stands-alone and https://www.fdic.gov/news/news/speeches/spapr1218.html.
[13] https://ourfinancialsecurity.org/2019/05/speech-former-fed-governor-tarullo-decries-low-intensity-deregulation/

6. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, please provide the Committee with a list of proposals that your agency has made, or is planning to make, that is responsive to recommendations by the Department of the Treasury in its series of regulatory reform reports and memoranda issued in 2017 and 2018.[14]

[14] https://home.treasury.gov/policy-issues/top-priorities/regulatory-reform

The Board of Governors of the Federal Reserve System (Board) has reviewed the reports issued by the Department of the Treasury. The reports covered the banking system, capital markets, asset management and insurance, as well as non-bank financial institutions, and provided recommendations regarding laws, regulations, and other policies administered by the federal financial regulators. The reports recommended streamlining, clarifying, and reducing burden associated with several regulations and statutes administered by the federal financial agencies, including the Volcker rule, the enhanced prudential standards, and stress testing.

The Board, like many other central banks, is an independent government agency and endeavors to fulfill its statutory mandates and objectives, as defined by Congress. The Board conducts periodic reviews of its rules to update, reduce unnecessary costs associated with, and streamline regulatory requirements based on its supervisory experience and consistent with the effective implementation of its statutory responsibilities. These efforts include assessing the impact of regulations as well as exploring alternative approaches that could achieve regulatory objectives while improving the regulatory framework's simplicity, transparency, and efficiency. To this end, the Board, Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) have issued final amendments to our capital rule for bank holding companies, savings and loan holding companies, and state member banks.[1] The amendments simplify and clarify a number of the more complex aspects of the rule, such as the capital treatment for mortgage servicing assets, certain deferred tax assets, investments in the capital instruments of unconsolidated financial institutions, and the calculation for the amount of capital issued by a consolidated subsidiary of a banking organization and held by third parties (sometimes referred to as a minority interest) that is includable in regulatory capital. In addition, the Board has sought to improve the transparency of its stress testing program for the largest and most complex banks. These changes are intended to improve public understanding of the

[1] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190709a.htm.

program while maintaining its ability to independently test large banks' resilience.

In addition, the agencies have been working expeditiously to implement provisions of S.2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), including provisions that would provide reporting and regulatory relief for community banking organizations and more tailored prudential standards for large banking organizations.

Most recently, the Board finalized rules that tailor its regulations for domestic and foreign banks to more closely match their risk profiles. The rules reduce compliance requirements for firms with less risk while maintaining the most stringent requirements for the largest and most complex banks. The rules build on the Board's existing practice of tailoring its requirements and are consistent with changes made by the EGRRPA.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Chairwoman Maxine Waters:

Deregulating Megabanks – Capital, Leverage, Stress Testing, Living Wills

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[4] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.
[5] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm.
[6] https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20181031.pdf

[7] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm
[8] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm[9] Alan Rappeport and Emily Flitter, "Regulators Move to Ease Post-Crisis Oversight of Wall Street," New York Times (Mar. 6, 2019),
https://www.nytimes.com/2019/03/06/business/bank-regulation.html
[10] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm
[11] https://www.fdic.gov/news/news/press/2019/pr19035.html
[12] For example, see https://www.americanbanker.com/news/the-feds-lael-brainard-stands-alone and https://www.fdic.gov/news/news/speeches/spapr1218.html.
[13] https://ourfinancialsecurity.org/2019/05/speech-former-fed-governor-tarullo-decries-low-intensity-deregulation/

7. Vice Chairman Quarles, if the Fed holds itself up as being independent of the executive branch, why is it prioritizing the implementation of many of the Trump Administration's deregulatory proposals, as articulated by the Treasury Department, to ease capital requirements and stress testing for Wells Fargo and all the other G-SIBs?

During my tenure at the Federal Reserve Board (Board), I have focused on updating the post-crisis regulatory regime to improve the efficiency, transparency, and simplicity of the Board's supervision and regulation. Regulatory capital and liquidity requirements for the global systemically important banks (GSIBs) have remained strong and largely unchanged, and GSIBs continue to be held to the highest supervisory standards and regulatory requirements, reflecting their systemic importance.

Most of the proposals referred to in your letter have a relatively minor impact on the overall stringency of the regulatory and supervisory regime applicable to GSIBs. In fact, certain proposals would increase the stringency of requirements for GSIBs, such as the stress capital buffer proposal, which was estimated to increase common equity tier 1 (CET1) requirements for GSIBs in the aggregate.[1]

The enhanced supplementary leverage ratio (eSLR) proposal released in April 2018 was expected to have only a negligible effect on the binding capital requirements for GSIBs. Specifically, Board staff estimated that the proposed changes to the eSLR would reduce the required amount of tier 1 capital for the holding companies of affected firms by approximately $400 million, or approximately 0.04 percent in aggregate tier 1 capital.

The tailoring proposal released in October 2018 largely left intact the enhanced prudential standards for GSIBs. Only minor changes were made to stress testing requirements for GSIBs, as required by S.2155, which were the removal of the mid-cycle stress test requirement and the removal of the requirement that firms perform their company-run stress tests under an adverse scenario.[2] The mandatory mid-cycle stress test provided modest risk-management benefits and limited incremental information to market participants beyond what the annual company-run stress test provides. With regard to the scenario, the firms would still be required to test

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[1] As stated in the proposal, the stress capital buffer is estimated to represent an increase in CET1 requirements at GSIBs of approximately $10 billion to $50 billion in aggregate.

[2] Similarly, the Board would no longer include an "adverse" scenario in its supervisory stress tests.

themselves against a more severe hypothetical scenario, known as the "severely adverse" scenario, and the supervisory stress tests also would continue to include a "severely adverse" scenario. The proposal did not make changes to any other GSIB requirements.

The countercyclical capital buffer (CCyB) is set based on the framework detailed in the Board's policy statement for setting the CCyB for private-sector credit exposures located in the United States. The buffer is a macroprudential tool that can be used to increase the resilience of the financial system by raising capital requirements on internationally active banking organizations. The Board voted on March 6, 2019, to maintain the CCyB at zero percent for 2019.[3] The Board has affirmed the CCyB at zero percent for each of the past four years.

The supervisory work that has served as the basis for the qualitative objection from Comprehensive Capital Analysis and Review (CCAR) for GSIBs, has been incorporated into the Board's ongoing supervisory program, where GSIBs will continue to be subject to a rigorous evaluation of their capital planning processes. Firms with weak practices may be subject to a deficient supervisory rating, and potentially an enforcement action, for failing to meet supervisory expectations. In addition, all GSIBs remain subject to a potential objection on quantitative grounds.

The changes proposed in the resolution plan tailoring proposal for GSIBs were a codification of current practice. The practice of requiring a resolution plan submission every other year appropriately balances the burden of filing with the systemic value of having updated plans. In addition, given that the U.S. GSIBs' resolution plans have matured over time and that these firms have taken meaningful steps to develop the foundational capabilities necessary for the implementation of their resolution strategies, it was determined that a two-year filing cycle is appropriate.

These proposals are reasonable amendments to the post-crisis regulatory regime and demonstrate that the Federal Reserve continues to optimize its regulatory framework by evaluating the costs and benefits of individual policies and the framework as a whole.

10. Vice Chairman Quarles, what is your response to former Governor Tarullo's concerns that the Federal Reserve's efforts to promote so-called transparency in stress testing may already allow megabanks to reverse engineer the test, allowing them to engage in regulatory arbitrage?

Transparency not only provides additional due process to participants, it creates an opportunity for broader, more insightful comments from the public. The credibility of the stress test has been built over the years, in part, through careful and regular efforts to improve the transparency of the test.

The enhanced disclosure of our supervisory models represented a considerable increase in the transparency of the stress testing regime. The disclosure provides the public with more information about the models but should not give firms enough information to simply "clone"

[3] The Board voted 4-1 to maintain the level of the CCyB at zero.
See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.

the Board's models in ways that could lead to an accumulation of risks around the errors and idiosyncrasies of those models. I believe that the recent disclosure of our supervisory model methodology strikes a good balance between the benefits of enhanced transparency and the risks associated with providing firms too much detail about our models.

- **In addition, is the Federal Reserve considering including the enhanced supplementary leverage ratio that it previously exempted from its proposed stress capital buffer to ensure the proposal does not decrease capital requirements for megabanks? What steps are being taken to ensure megabank capital and leverage requirements are not decreasing when considering the totality of proposals the Federal Reserve is making?**

As you noted, the stress capital buffer proposal would have introduced a stress leverage buffer requirement.[4] However, by its nature, a leverage ratio is a blunt instrument that treats all assets the same and therefore is not risk-sensitive. Thus, there is concern that explicitly assigning a stressed leverage requirement to a firm on the basis of risk-sensitive post-stress estimates is in conflict with the intellectual underpinnings of the leverage ratio. As I have stated, any changes proposed to the capital regime will aim to preserve the currently strong capital levels in the banking system. I would note that GSIBs will continue to be subject to an enhanced supplementary leverage ratio standard under the regulatory capital rule which was designed and calibrated to strengthen the largest and most interconnected banking organizations' capital base and to preserve the complementary relationship between risk-based and leverage capital requirements in recognition that risk-based capital requirements had increased in stringency and amount.

As stated previously, GSIBs continue to be held to the highest supervisory standards and regulatory requirements, reflecting their systemic importance. For U.S. GSIBs, the stress capital buffer proposal would generally maintain, and in some cases increase, CET1 capital requirements because it would add a new charge on U.S. GSIBs. The proposal would be expected under certain circumstances to result in a reduction to required levels of capital for certain smaller, regional bank holding companies. In the aggregate, the Board expects the proposal to have a roughly neutral impact on the amount of CET1 capital in the U.S. banking system, as measured over the economic and credit cycle.

11. Vice Chairman Quarles, much of the data that firms submit for resolution plans and stress testing hold enormous value by identifying possible safety and soundness weaknesses, such as the leveraged loan data, and provide insight into the resiliency of financial institutions. Why are regulators proposing to limit the submission of this data?

In the resolution-planning context, the Board and the Federal Deposit Insurance Corporation (FDIC), in practice, have extended submission deadlines for the largest firms. Those extensions have effectively resulted in bi-annual submissions for the U.S. GSIBs, in large part due to the recognition that the Board and the FDIC benefit from more time to conduct reviews and give meaningful feedback to firms. In addition, as firms have progressed structurally in their resolution preparedness, Board staff do not expect large-scale changes to occur in the periods between submissions. If material changes do occur between submissions, Board staff expect to

[4] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180410a.htm.

be able to learn about and analyze them in the normal course of supervision. In addition, the Board and FDIC may jointly require interim updates or off-cycle plan submissions where further information is needed regarding large-scale changes that occur between submissions.

S.2155 required the Board to promulgate a change to the asset threshold for company-run and supervisory stress tests. Pursuant to the statutory change, the Board has proposed to remove the requirement for certain smaller and less risky firms to report projections from their own stress tests. The Board will continue to collect detailed loan- and portfolio-level data associated with the supervisory stress test from all firms subject to the company-run and supervisory stress tests. Continuing to use those data to run the supervisory stress test will allow the Federal Reserve to effectively assess whether firms have sufficient capital to continue operating and lending to households and businesses, even during times of economic and financial market stress.

Fintech

There has been tremendous interest in financial technology, or fintech, and the Committee has formed two task forces to more closely examine fintech and AI.

14. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles: GAO issued a recent report making a series of recommendations that the regulators coordinate better on fintech issues.[15] Please outline what specific steps is your agency taking to respond to these recommendations, and coordinate better with other regulators?

[15] https://www.gao.gov/products/GAO-18-254

Relating to the Government Accountability Office's (GAO's) recommendations, the following actions have been taken by the Federal Reserve.

The Chair of the Board of Governors of the Federal Reserve System should invite the National Credit Union Administration to participate in the Interagency Fintech Discussion Forum.
We agree that the National Credit Union Administration's (NCUA) oversight of credit unions provides it with experiences and perspectives that are relevant to the group's collaborative work on fintech consumer protection issues. Accordingly, relevant contacts at the NCUA have been invited to take part in meetings of the Interagency Fintech Discussion Forum and they have joined in those discussions.

Coordinate with the Federal Communications Commission concerning their participation in the 2018-2019 Federal Reserve's Mobile Payments Industry Working Group.
With respect to the two recommendations for the Federal Reserve to include the Federal Communications Commission (FCC) in its Mobile Payments Industry Working Group, the FCC joined the Work Group's June 18, 2019 meeting. In addition to participating throughout the day's discussions, FCC staff contributed to a panel on "U.S. Data Protection and Privacy Developments" moderated by the Cellular Telecommunications Industry Association and joined by panelists from the Federal Trade Commission (FTC) and Consumers Union.

The Chair of the Board of Governors of the Federal Reserve System should engage in collaborative discussions with other relevant financial regulators in a group that includes all relevant stakeholders and has defined agency roles and outcomes to address issues related to consumers' use of account aggregation services.
The Federal Reserve recognizes the importance of collaboration when determining how best to encourage socially beneficial innovation in the marketplace, while ensuring that consumers' interests are protected. The Federal Reserve and other regulators have already committed to coordinating on these issues in a number of fora, including the Federal Financial Institutions Examination Council (FFIEC) Task Force on Supervision, the FFIEC Task Force on Consumer Compliance, and the Interagency Fintech Discussion Forum.

This calendar year, the Federal Reserve has also organized a number of meetings with industry representatives, trade associations, and consumer advocates on a variety of fintech topics, including financial account aggregation. These meetings have included joint participation from relevant regulators, including the OCC, FDIC, Consumer Financial Protection Bureau, the FTC, and the Conference of State Bank Supervisors. We will continue to facilitate and engage in collaborative discussions with other relevant financial regulators in these and other settings.

The Chair of the Board of Governors of the Federal Reserve System should formally evaluate the feasibility and benefits to their regulatory capacities of adopting certain knowledge-building initiatives related to financial innovation.
The Federal Reserve recognizes the importance of establishing formal mechanisms to increase its knowledge base as it relates to financial innovation. Among other efforts that focus on financial innovation, the Federal Reserve System (System) has organized System-wide teams of experts tasked with monitoring fintech and related emerging technology trends as they relate to our supervisory and payment system mandates, respectively. The teams include representation from all of the System's Reserve Banks and include leadership from Board staff. The teams' critical objectives include ensuring that fintech-related information is shared across the System and inform relevant supervisory, policy, and outreach strategies.

Further, several of the Board's divisions have committed substantial staff resources to policy development and research around fintech and digital innovations in their respective areas of focus. Through these initiatives, conferences, and international organizations, Board members as well as Board and System staff routinely meet with banks, technology firms and other stakeholders, as well as domestic and foreign regulators to gather updates on new technologies and regulatory innovation.

19. Vice Chairman Quarles, what concerns, if any, do you have about Bitcoin and the use of other virtual currency in the U.S. banking system? Should banks promote or discourage their use?

There are a variety of digital currencies currently available and many are in development. They raise a number of potential concerns, but their underlying technology may also create beneficial developments for the financial system. In their current form and as a relatively small portion of all financial assets and the global financial system, digital currencies, such as cryptocurrencies including bitcoin, pose limited concerns with respect to monetary control or financial stability.

Nonetheless, a less volatile "stable coin" offered through a widely adopted platform—such as Facebook's Libra coin—could reach a scale that changes those dynamics.

Consumers and investors active in cryptocurrencies can face diverse risks such as fraud, loss, and identity theft, as well as hidden fees and opaque costs when interacting with cryptocurrency service providers. Additionally, consumers may incorrectly assume they enjoy the same protections for cryptocurrencies as they do with traditional financial assets and intermediaries.

Domestic and international regulators continue to be concerned with the use of cryptocurrencies for money laundering, terrorist financing, and other financial crimes. To comply with certain regulations designed to protect the U.S. financial system from money laundering or terrorist financing, banks are required to collect the name, date of birth, address, and identifying number (e.g., Social Security, Passport, or Taxpayer Identification numbers) from all customers, including customers dealing in cryptocurrencies, understand the purpose and nature of the customer activity, and report suspicious activity.

Cryptocurrencies, such as bitcoin, also have experienced challenges in satisfying money-like properties as they have not become stable stores of value, achieved widespread adoption as a generally accepted payment method, nor have they become common units of account.

Risk management can act as a mitigant, but if the central asset in a payment system cannot be predictably redeemed for the U.S. dollar at a stable exchange rate in times of adversity, the resulting price risk and potential liquidity and credit risk pose a large challenge for the system. There are also operational risks if there are large surges in the number of transactions as holders of an asset try to settle purchases and sales of transactions in a concentrated window of time.

The underlying distributed ledger technology may have the potential to make payments faster and less costly. Depending on the design and governance of the implementation, it may reduce the time necessary for banks to conduct due diligence and help them understand the sources and destinations of payments. While there are several areas where cryptocurrencies and distributed ledger technology may hold promise, the extent to which they ultimately are adopted and the totality of challenges posed remain to be seen. The Board will continue to monitor developments in this area, with the objective of fostering long-run innovation while continuing to safeguard the public interest.

- **What protections are needed to ensure these cryptocurrencies can't be used to evade anti-money laundering laws?**

Domestic and international regulators continue to be concerned about the potential for cryptocurrency networks to be used for money laundering and terrorist financing.

The Financial Crimes Enforcement Network (FinCEN), the administrator of the Bank Secrecy Act (BSA), has issued guidance stating that BSA obligations apply to virtual currency administrators and exchangers (cryptocurrency providers) consistent generally with the anti-money laundering oversight of other money services businesses, including a requirement to register with FinCEN.

The Board and the other federal banking agencies have authority to conduct examinations of depository institutions, including those with cryptocurrency customers, for compliance with BSA requirements in order to limit instances of money laundering and terrorist financing in the U.S. financial system.

The Financial Action Task Force (FATF), the international standard setter for measures for combating money laundering and terrorist financing, includes Federal Reserve Board staff as part of the U.S. delegation. The FATF has issued guidance that requires countries to assess and mitigate risks associated with virtual asset financial activities and providers; to license or register providers and subject them to supervision or monitoring by competent national authorities; and to make virtual asset service providers subject to FATF measures similar to those that apply to banks.

The Board, in cooperation with FinCEN and the other banking agencies, has conducted training for examiners that highlights anti-money laundering (AML) requirements that apply to virtual currency providers, and how such customers could affect a bank under our supervision.

At this time, only a small number of banks that we supervise provide banking services to the primary domestic cryptocurrency exchanges. Our review of those relationships is ongoing but, so far, we have not identified major concerns about these types of banking relationships.

Payday Loans and Small Dollar Credit

Some of the biggest concerns regarding payday loans and the small dollar credit industry are that consumers end up in "debt traps" whereby consumers are borrowing one loan to pay off another. On April 30th, our Consumer Protection and Financial Institutions Subcommittee held a hearing entitled "Ending Debt Traps in the Payday and Small Dollar Credit Industry." Rev. Dr. Haynes from the Friendship West Baptist Church in Dallas, TX, testified about one his congregants, stating "One of my members, a 74-year-old senior citizen, who is feisty and fiercely independent, discovered she didn't have the money to pay a bill. She saw a commercial for a payday loan and felt it was an answer to prayer. Now she feels like the devil answered her prayer. She is on a fixed income and when the repayment was due, she didn't have enough and had to take out another loan to pay the first one. She ended up with a dozen loans. When she approached me for help one Sunday after church, this once proud senior saint with good credit, was ashamed and tearful. She showed me the paperwork. I was appalled. The interest rate was 620%! She was "dealt a bad hand with a bad plan." She was hurting for help. She took the bait of the payday loan and became trapped in debt that made her bad situation so much worse."

31. Comptroller Otting, Chairman McWilliams, Chairman Hood, and Vice Chairman Quarles, what kinds of measures can you as regulators put in place to ensure that banks aren't charging interest rates above 36%?

We share your concern that the structure of certain loans can lead consumers into a cycle of repeated borrowing over an extended period of time, and we have long encouraged the state

member banks we supervise to respond to their customers' small-dollar credit needs with products that meet this demand in a responsible manner.

Other than the Military Lending Act and the Servicemembers Civil Relief Act, federal consumer protection laws generally do not impose any rate caps on credit products provided by the institutions we supervise. Whether there should be other rate caps on credit products is a matter for Congress to decide. The Board stands ready to enforce any new laws Congress enacts under the Board's jurisdiction.

Diversity and Inclusion – Federal Reserve

Based on committee staff analysis of the 12 Federal Reserve Banks' OMWI reports, Federal Reserve Banks on average experienced a less than 1% increase for women and minorities in officer, exempt and non-exempt positions from 2015 through 2018. That average decreased even more for exempt positions for the same time period, which includes professional positions such as economists, attorneys and financial analysts.

37. Vice Chairman Quarles, although each Federal Reserve Bank has its own diversity initiatives, what expectations and goals have been set forth at the system wide level to increase the presence of women and minorities across the Federal Reserve System?

The Federal Reserve is committed to ensuring equality in all aspects of its employment, and to fostering diversity and inclusion in the workplace. The Federal Reserve uses a variety of recruitment sources to attract a diverse pool of well-qualified candidates to fill positions as well as providing developmental opportunities for the workforce to compete successfully for management positions. We continue to complement our recruitment sources using social media, campus recruiting with historically black colleges and universities, Hispanic-serving institutions, diverse professional organizations such as the Executive Leadership Council, INROADS, and Hispanic and Black Masters of Business Association.

Diversity and Inclusion – Full Panel

In June 2015, your agencies along with the SEC and the CFPB adopted the Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies. Despite urging from many Democrats that those standards for diversity assessments be mandatory and publicly disclosed by regulated entities, the final standards were voluntary, leaving an opportunity for continued opaqueness about industry diversity and inclusion. Under the voluntary standards, our review of your most recent OMWI reports reveals that each of your agencies have low participation by your regulated entities in completing the requested diversity and inclusion self-assessment. For example, among your respective regulated depository institutions, only 16% reported to FDIC; 9.3% reported to OCC; 6.0% reported to the Fed; and a mere 1.5% reported to NCUA the results of their diversity self-assessments.

43. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, what plans have you discussed with your OMWI directors and your regulated entities about how to increase participation in providing diversity self-assessments?

The Office of Minority and Women Inclusion (OMWI) receives, tracks and assesses the regulated entities' Diversity and Inclusion (D&I) Self-Assessments. The Board continues to emphasize the importance of institutions' participation in these self-assessments and how impactful policies and practices can create and sustain D&I inclusion in the financial industry. To that end, the Board's OMWI collaborated with the OMWIs of the other federal financial regulatory agencies to convene the "Financial Regulatory Agencies' Diversity and Inclusion Summit" on September 13, 2018, which was hosted by the Federal Reserve Bank of New York.

Approximately 100 companies headquartered on the East Coast attended. The primary purpose of the summit was to enable company representatives to meet the OMWI directors and receive updates on the implementation of the Joint Standards[5] for assessing diversity policies and practices, and for OMWI directors to hear insights on leading diversity practices from financial industry organizations and diversity champions in the financial services sector.

Later this year, a similar meeting will be convened in Chicago.

44. For the diversity data that has been shared, what type of analysis and advice, if any has been shared about regulated entities' diversity and inclusion efforts?

In its report to Congress, the OMWI includes an aggregate assessment of the institutions that have provided information regarding their D&I practices. Leading practices were discussed at the federal financial regulatory agencies' Diversity and Inclusion Summit, referred to in my response to question 43. The topic is again on the agenda to be discussed at the upcoming Summit to be held later this fall.

45. What type of guidance has been provided to bank examiners on how to evaluate diversity and inclusion practices at regulated entities?

While the Federal Reserve does not have the statutory authority to examine financial institutions for D&I, the OMWI is responsible for the receipt and review of D&I self-assessments submitted by regulated entities. The OMWI directors of the federal financial regulatory agencies meet quarterly to discuss assessment results and ways to collaborate with the industry in addressing identified priority focus initiatives.

46. At your agencies, who do OMWI directors report to and to what extent are OMWI directors and other leadership at your agencies, including you, accountable for diversity results?

The Board's Office of Diversity and Inclusion (ODI) administers and directs the Board's Equal Employment Opportunity compliance policies and programs, and the OMWI. The OMWI director maintains a quarterly meeting schedule with myself and Chair Powell, as well as with

[5] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20100621a.htm.

the Program Director for ODI. The meetings provide opportunities to discuss the Board and Federal Reserve Banks' diversity policies, programs, performance, and relevant rule makings under consideration.

Incentive-Based Compensation

The Wells Fargo fraudulent account scandal, and its incentive-based cross-selling strategy that fueled it, is a stark reminder how important it is for financial regulators to finalize executive compensation rules. As you know, Section 956 of the Dodd-Frank Act directed the regulators to adopt joint rules aimed at prohibiting incentive compensation arrangements that could encourage inappropriate risks at financial institutions. The regulators made an initial proposal in 2011, then reworked the proposal and issued a new plan in 2016. The proposal increases in stringency based on the financial company's asset size with enhanced requirements for senior executive officers and significant risk-takers.

47. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, there was much discussion at the hearing regarding the fast implementation of S. 2155 enacted by the 115th Congress. However, there are a few much older mandates that your agencies have not yet finalized. For example, given that Section 956 of the Dodd-Frank Act regarding incentive-based compensation is not a discretionary requirement, but a mandatory one, what steps are each of your agencies taking to prioritize the rule's implementation and enforcement this provision of the law?

The Board continues to evaluate incentive compensation practices as a part of ongoing supervision, focusing on ensuring robust risk management and governance around incentive compensation practices rather than prescribing amounts and types of pay and compensation. The Board, along with the other federal banking agencies, issued Guidance on Sound Incentive Compensation Policies in June 2010.[6] This interagency guidance is anchored by three principles: balance between risks and results, processes and controls that reinforce balance, and effective corporate governance. This guidance directs our supervisory efforts.

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

As regulators, you have indicated that relieving the burdens on banks, especially those placed on banks through the Bank Secrecy Act is a highest priority. While compliance is expensive, the trade off in lowering BSA compliance standards is potentially weakening safeguards to combat terrorists and criminal activity where their financing flows through the U.S. financial system.

50. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, banks and credit unions often complain they do not receive meaningful feedback on whether their efforts on BSA/AML are helpful to law enforcement. What steps is your agency taking to provide better feedback and guidance to community banks and credit unions?

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[6] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20100621a.htm.

The Board recognizes that effective implementation of the BSA requires collaboration between the government and financial institutions, including community banking organizations and credit unions. Industry representatives have conveyed to the Board that financial institutions would like to have greater feedback on whether the reports financial institutions are required to file by law with the FinCEN are useful to law enforcement. FinCEN is the agency responsible for administration of the BSA and serves as a liaison between financial institutions and law enforcement concerning BSA reports. Because of its role, the Board works closely with FinCEN to encourage FinCEN to provide greater feedback to financial institutions regarding BSA reports. The Board has also taken steps to ensure that law enforcement is aware of the industry's desire for feedback. This issue is one of several potential initiatives being considered by the Board and other supervisory agencies to improve the efficiency and effectiveness of the BSA.

- **What steps is your agency taking to ensure law enforcement has all the information it needs to combat terrorism and illicit activity?**

We regularly examine financial institutions under our supervision, in accordance with the mandated exam schedule, for BSA/AML compliance. Through this process we seek to ensure that compliance at financial institutions under our supervision is strong, that the financial institutions' boards of directors and management have a demonstrated commitment to compliance, and that those institutions are complying with regulatory requirements, such as filing appropriate Suspicious Activity Reports and Currency Transaction Reports, to ensure law enforcement has all the information it needs to combat terrorism and illicit activity.

Financial Stability and Lessons from the Financial Crisis

52. Comptroller Otting, Chairman McWilliams, Chairman Hood and Vice Chairman Quarles, given that FSOC is taking a so-called "activities-based approach" to supervising for systemic risk, is that any different than the weak financial stability oversight we had before the financial crisis, especially since FSOC has no authority to mandate new regulations to address systemic concerns identified through an activities-based approach?

Since the end of the financial crisis, the Board and other financial regulators have used their expanded prudential authorities to strengthen the resiliency of the financial system through a large number of structural reforms. The proposed guidance does not affect the supervisory activities of the members of the FSOC.

55. Chairman Hood, Chairman McWilliams, Comptroller Otting, and Vice Chairman Quarles, has the Financial Stability Oversight Council (FSOC) helped to eliminate regulatory gaps in our financial regulatory system? Should Congress consider legislation to strengthen FSOC's tools to ensure it is well equipped to head off a future crisis?

The FSOC has provided a forum for members to share information and analysis related to a broad range of financial institutions and markets. This information sharing and coordination helps members to identify and address potential gaps and weaknesses. Any decision to change the structure or authorities of the FSOC is one for Congress.

<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Barr:</u>

1. Kentuckians benefit from a vibrant economy with a more competitive market where banks, both foreign and domestic compete for their loans and underwrite their bonds. I worry that an imbalance in our regulatory framework will shrink the diverse sources of capital and the freedom of choice for our businesses and consumers. According to a recent SIFMA research report, international banks have reduced their broker dealer assets by more than 50% and their market share is down across all product types in recent years. For the largest international banks, the shrinkage has been even greater. As you move forward with this important proposal, I would urge you to look at two issues:

Complete an impact analysis and finalize the underlying capital and liquidity rules of this proposal, such as the Net Stable Funding Ratio and Stress Capital Buffer. Otherwise, we end up in a situation where banks are lumped into different categories and subject to rules that are not yet finished.

Do you intend to move forward with this proposal while underlying rules within the proposal are still being finalized?

I appreciate your concerns about the need to ensure consistency and cohesiveness in our regulations.

On October 10, 2019, the Federal Reserve Board finalized rules that tailor its regulations for domestic and foreign banks to more closely match their risk profiles. The rules reduce compliance requirements for firms with less risk while maintaining the most stringent requirements for the largest and most complex banks.

The Board's long-standing policy is to maintain a level playing field between foreign and domestic banks. This approach promotes more competitive markets in the United States and, because banking is a global business, helps to level the playing field for U.S. banks abroad.

The tailoring rules apply the same framework to large U.S. banking organizations and the U.S. operations of large foreign banks, with targeted adjustments to reflect the structure of foreign banks. The framework is designed to match the prudential standards with the risks of an institution. When firms of similar size are assigned into different categories, it reflects differences in their risks, such as different levels of weighted short-term wholesale funding.

As the Board works to finalize the Net Stable Funding Ratio proposal and the Stress Capital Buffer proposal, we will continue to take a holistic view of our regulatory structure for domestic and foreign banks to ensure a framework that is coherent, efficient, and effective.

2. I am also concerned that the tailoring proposal would apply liquidity regulation to an IHC based on the combined risk profile of an FBO's IHC and branches instead of just the risk profile of the IHC. Branches are separate legal entities and should be regulated separately from an IHC, based on their own risk profiles.

Why do you believe our regulations should include the branch assets when determining how to regulate the IHC?

If you have concerns about the branch would it be better to reconsider how the branch is regulated to match its risk profile?

The tailoring rule generally applies the same framework to foreign banks as would apply to domestic firms, with certain adjustments to reflect the structure of foreign banks' operations in the United States. As you note, the foreign bank tailoring proposals would have applied standardized liquidity requirements to the U.S. intermediate holding company of a foreign bank based on the risk profile of the foreign bank's combined U.S. operations. The final tailoring rule amended the proposal to apply liquidity coverage ratio standards to the U.S. intermediate holding company based solely on the risk profile of the U.S. intermediate holding company, and not on the profile of the related branch. This change simplifies and enhances the focus of the tailoring framework.

As part of the proposals, the Board asked whether it should consider applying separate liquidity requirements to the branches and agencies of foreign banking organizations. The Board is still considering whether to develop a standardized liquidity requirement for the U.S. branches and agencies of foreign banking organizations, and is planning to continue discussion and evaluation of the issue with peer prudential regulators at the international level.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Bill Foster:

3. Vice Chairman Quarles, Chairman McWilliams, and Comptroller Otting, I wanted to ask you about your approach to initial margin on inter-affiliate swaps:

a. The Fed, FDIC, and OCC require this margin on inter-affiliate financial transactions of U.S. banks, and it is estimated that nearly $40 billion is held to comply with this requirement. This seems to be inconsistent with international regulators that do not require inter-affiliate initial margin. Do you agree with this? Why or why not?

We recognize that the U.S. margin rules differ from those of our international counterparts. Federal Reserve staff is actively discussing this issue with the other prudential regulators to assess what, if any, changes can be made to the U.S. margin rules. Any such changes would need to be consistent with the statutory directive that margin requirements help ensure the safety and soundness of covered swap entities and are appropriate for the risk associated with non-cleared swaps.

b. Further, this requirement seems to be inconsistent with the CFTC's approach to non-bank swaps dealers. In fact, in adopting the final rule on margin for uncleared swaps in December 2015, former CFTC Chairman Timothy Massad noted that "Inter-affiliate transactions are not outward-facing and thus do not increase the overall risk exposure of the consolidated enterprise to third parties. Instead, they are typically a means for the consolidated enterprise to centrally manage risk related to the activities of multiple subsidiaries. Imposing the same third-party transaction standards on these internal activities of consolidated entities is likely to significantly increase costs to end-users without any commensurate benefit." Do you agree with this rationale? Why or why not?

Board staff is actively reviewing the application of initial margin requirements to inter-affiliate transactions. These efforts include ongoing discussions with the other relevant agencies, an assessment of how the current requirements help to protect the safety and soundness of covered swap entities and are appropriate for the risk associated with non-cleared swaps, an assessment of whether any changes to this aspect of the swap margin rule would be consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act, and a review of the interaction of this aspect of the rule with other regulations. Once these efforts conclude, the Board would consider whether any changes to the rule would be appropriate.

c. Last year, Vice Chairman Quarles testified in front of the House Financial Services Committee that this should be a priority for the Federal Reserve. Do you all agree it is a priority, and is there a timeline to make this requirement consistent with regulators around the world?

As stated in the response to question 3a, the Federal Reserve is actively discussing this aspect of the rule with the other prudential regulators.

4. Given significant concerns regarding the viability of the London Interbank Offered Rate ("LIBOR") as a robust benchmark rate, the Financial Conduct Authority, the U.K. regulator charged with LIBOR oversight, two years ago declared that at the end of 2021, it would no longer compel banks to submit the quotes needed to determine LIBOR. With approximately $400 trillion in financial contracts linked to LIBOR, the cessation of this benchmark will have significant ramifications across the global financial markets, impacting borrowers and consumers, lenders, investors, banks, and other market participants. Transitioning to a new benchmark (the Secured Overnight Financing Rate ("SOFR") in the U.S.) will require massive operational and technology changes for lenders, investors, banks, and others. The industry, in partnership with regulatory authorities, has already spent more than a year crafting language for new LIBOR-based instruments that will hopefully allow for a smoother transition.

However, over $2 trillion in "legacy" LIBOR financial contracts (i.e., entered into before appropriate benchmark replacement language was developed) that mature after 2021 pose an enormous problem to the financial system. These contracts include both LIBOR-based bonds and consumer loans, therefore affecting a wide range of financial market participants. These legacy bonds and loans simply do not contemplate the cessation of LIBOR and, therefore, when LIBOR disappears it is unclear what benchmark rate will underpin interest payments.

a. Vice Chairman Quarles, the gross notional value of all financial products tied to USD LIBOR includes $3.4 trillion of business loans, $1.8 trillion of floating-rate notes and bonds, another $1.8 trillion of securitizations, and $1.3 trillion of consumer loans held by about four million individual retail consumers, including around $1.2 trillion of residential mortgage loans. At the end of 2021, based on data from the Alternative Reference Rates Committee, it is estimated that roughly $2 trillion of LIBOR-based contracts will still be outstanding. We understand that most legacy LIBOR securities cannot be amended without 100% investor consent, which is impossible to achieve. As far as we can tell, there is no comprehensive proposal on how to manage this risk. Do you have a plan to address this issue?

As you note, many contracts did not plan adequately for a potential permanent disruption to London Interbank Offered Rate (LIBOR), and in many cases do not have fallback provisions that seem to be appropriate economically for such an event. The Alternative Reference Rates Committee (ARRC) and the Federal Reserve are assessing several options for these legacy contracts, but in many cases the solutions available may depend on the product and its specific circumstances.

Business loans, which represent the largest exposure among cash products, are renegotiated or amended fairly frequently and are negotiated among a relatively small number of parties, and so our expectation is that business loan contracts maturing past 2021 can be amended to adopt language that would have robust fallbacks in place. The ARRC has recommended fallback language for a variety of cash products that reference LIBOR for exactly this purpose. For many consumer products, notably adjustable rate mortgages, the lender or holder of the mortgage has the right to name a successor rate if LIBOR is unavailable, and the ARRC is working with a wide set of lenders, investors, and consumer groups in order to propose a successor rate that all

parties consider to be fair and transparent.

Legacy floating rate debt and securitizations (with the exception of some Agency mortgage-backed securitizations) are addressed less easily because they require unanimous investor consent, as you indicate. The ARRC is considering engagement with the state of New York to seek legislative relief for these products, and other legal remedies may be available for some securitizations. We will continue to work with the ARRC to assess the options available for these legacy products.

b. Vice Chairman Quarles, SOFR is an overnight rate. LIBOR is a forward-looking rate which reflects the market's expectations about where rates will be in the future. Many segments of the industry, including lenders and borrowers, need to know what interest rate will be driving payments in the future. (For example, a borrower with an adjustable rate mortgage knows what his or her underlying rate will be a year from now.) The Federal Reserve has said it is trying to develop a term rate structure by 2021 that will allow for this estimation of future rates. How confident are you that this will happen?

The ability to produce a robust, International Organization of Securities Commissions (IOSCO)-compliant, forward-looking term rate, that is based on the secured overnight financing rate (SOFR), derivative markets will depend on private market uptake of SOFR, and hence cannot be guaranteed. While these term rates will be useful to some, the Financial Stability Board also has noted that stability will be enhanced if most products reference overnight rates such as SOFR. For these reasons, while the ARRC is fully dedicated to speeding the production of a robust term rate where it can, it also has emphasized that, where possible, market participants should seek to transition now and not wait for the term rate. There are ways to use SOFR that allow borrowers to know their rate in advance; for example, the ARRC is working with Fannie Mae and Freddie Mac on a new model for a SOFR-based adjustable-rate mortgage that will ensure that consumers are able to know their payments well in advance, consistent with applicable consumer regulation and consumer needs. If market participants commit themselves to the transition and these kinds of steps, seeking to use SOFR, where possible, as the ARRC has recommended, then I believe we can be reasonably confident that robust, IOSCO-compliant term rates can be developed before the end of 2021.

c. Vice Chairman Quarles, we see that a handful of banks as well as GSEs have issued SOFR-linked bonds. The SOFR derivatives and futures markets are also increasing in size. But is overall SOFR liquidity (bond issuances, derivatives, futures) where you'd like it to be given that LIBOR will likely cease to exist in two and a half years?

The development of SOFR markets over the past year has been quite rapid, thanks to the dedication of many ARRC members fostering the transition away from LIBOR. We must keep in mind that new markets take time to develop but it is important that the rate of progress continues to accelerate. While there is no requirement that market participants use SOFR, they should take responsibility for transitioning away from LIBOR. The Federal Reserve's supervisory teams are including the transition away from LIBOR in their monitoring discussions with large firms, and will expect to see an appropriate level of preparedness at the banks we supervise.

<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Jesus "Chuy" Garcia:</u>

1. Former Federal Reserve General Counsel Scott Alvarez once testified to Congress that Industrial Loan Companies should be treated as bank holding companies and supervised by the Federal Reserve. Does this remain the Federal Reserve's position?

The statutory exemptions from the Bank Holding Company Act for industrial loan companies (ILCs) place those institutions outside of the Board's supervision and regulation. Any change that would apply Board oversight to those firms would be a decision for Congress. It has been my experience that ILCs have been a stable source of capital for creditworthy business and individuals in our communities.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Josh Gottheimer:

1. NSFR

How does the Board know if it is calibrating the application of the proposed Net Stable Funding Ratio rule appropriately before the Board has finalized the requirement and analyzed the full impact of the requirement on FBOs, given that this was absent in the proposal and the NSFR was not intended for a subsidiary of a consolidated organization?

The foreign bank tailoring proposals issued by the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Board), and the Office of the Comptroller of the Currency (OCC), (collectively, the agencies) would amend the scope of application of the liquidity coverage ratio rule and proposed net stable funding ratio (NSFR) rule. Under the NSFR proposed rule issued in 2016, an NSFR requirement or modified NSFR requirement would apply to U.S. intermediate holding companies of foreign banking organizations that are depository institution holding companies with total assets of $50 billion or more. In connection with proposing to amend the scope of capital and liquidity requirements and the Board's enhanced prudential standards generally, the agencies also would have aligned the proposed NSFR rule's scope of application. More generally, the foreign bank tailoring proposals seek to apply a consistent framework to foreign banking organizations as would apply to domestic firms, in order to provide consistent treatment of risks across firms and a level playing field.

The agencies proposed the NSFR rule in 2016 and received a number of comments on the overall requirement as well as on specific aspects of the rule. The Board has been working with the OCC and FDIC to consider those comments, as well as the plans to consider any comments on the foreign bank tailoring proposals as the agencies work to develop a final rule.

The tailoring proposals did not propose changes to the scope of application of the proposal to implement the stress capital buffer. As with the NSFR proposal, the Board would consider any comments on the tailoring proposals as the agencies work towards developing final rules on stress testing.

2. Inter-Affiliates

The Board has proposed the same risk-based indicators (RBIs) to tailor requirements on foreign banks as the Board proposed for domestic banks. Since foreign banks' structures are different (i.e., they are subsidiaries of a global parent and not a top-tier institution), why has the Board chosen not to exclude certain intercompany transactions that pose a low run risk, including transactions with non-US affiliates, from the risk-categorization metrics?

The proposed approach is intended to promote a competitive playing field and consistent treatment of risks across firms. The proposals would apply generally the same framework to

both U.S. and foreign banking organizations with certain adjustments to address differences between foreign and domestic banking organizations. The proposed cross-jurisdictional activity indicator would exclude intercompany liabilities and certain collateralized intercompany claims in order to reflect the structural differences between foreign banking organizations' operations in the United States and domestic holding companies. For the weighted short-term wholesale funding indicator, the proposals would not exclude exposures between the U.S. operations of a foreign bank and non-U.S. affiliates. As stated in the proposal, this approach provides a way to address the potential for risks to spread across all segments of a banking organization and the risks posed by foreign banks with significant U.S. operations to financial stability. The proposals also request comment on the composition of the risk-based indicators, including whether to exclude additional intercompany claims from cross-jurisdictional activity.

The Board has received a number of comments on the proposed indicators, and we are carefully considering them as we work to develop a final rule.

3. Nonbank Asset Indicator

I was a lead sponsor last Congress of the Systemic Risk Designation Improvement Act, which called upon the Federal Reserve to use more risk sensitive metrics in applying heightened regulatory requirements to banks. I applaud the Federal Reserve for taking some positive steps in this direction through the use of risk-based indicators as a basis for tailoring regulatory requirements for banks. However, I am concerned that some of the indicators the Federal Reserve uses are not very risk sensitive. In particular, the nonbank asset indicator seems like a crude metric that arbitrarily penalizes firms engaged in capital markets activities even though those activities are not inherently more complex or risky than those of banking activities and even though broker dealers are often major holders of liquid and high-quality assets like Treasuries. Couldn't this indicator be improved and made more risk sensitive to ensure that broker dealers aren't penalized for holding Treasuries and other liquid and high-quality assets?

In general, the tailoring proposals aim to strike a balance between simplicity and risk-sensitivity in the selection of risk-based indicators, and to use indicators that reflect risks to the safety and soundness of a firm and to U.S. financial stability. To promote transparency and predictability, and to reduce compliance costs, the proposals would use indicators that are already used in the Board's regulatory framework and that are publicly reported by firms.

The Board has received a number of comments on the proposed indicators, including the proposed nonbank assets indicator, and we are carefully considering them as we work to develop a final rule.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative French Hill:

1. Fintech

The U.S. Treasury Department issued their "Nonbank Financials, FinTech and Innovation" report in July 2018 which provides a thoughtful and comprehensive report on ways to maintain and enhance America's financial technology competitive edge.

Based on your experience and leadership regulating financial institutions across the country, what do you believe are the top issues from the report that Congress should be prioritizing as part of our work on the FinTech and AI task force?

The Federal Reserve is monitoring actively developments in financial technology through the lens of our long-standing public policy goals of safety and soundness of financial institutions, consumer protection, safety and efficiency for the payment system, and financial stability.

In my role as Vice Chair for Supervision, I see innovation as something that can and should be fostered, while ensuring any risks that may arise are appropriately identified and managed. This viewpoint was underscored in remarks I gave discussing agile and effective regulation for the 21st century economy.[1] More recently, Federal Reserve Board (Board) staff provided a statement to be included in the official record of the hearing held by the House Financial Service Committee's Task Force on Financial Technology on June 25, 2019.[2] That statement highlighted the benefits and risks associated with fintech products and services; namely, the testimony highlighted safety and soundness concerns, compliance concerns, consumer protections, financial inclusion, the interplay between legacy systems and fintech systems, and cryptocurrencies.

Additionally, in public remarks made by other Board Members, these important topics have addressed, including topics such as improving the clarity and efficiency of our regulatory frameworks, cloud technologies and financial services, big data, machine learning and artificial intelligence, and consumer financial data.[3]

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[1] See Randal Quarles, "Thoughts on Prudent Innovation in the Payment System," November 30, 2017, https://www.federalreserve.gov/newsevents/speech/files/quarles20171130a.pdf.

[2] See https://www.federalreserve.gov/foia/files/statement-for-the-record-20190703.pdf.

[3] See Michelle W. Bowman, "Community Banking in the Age of Innovation," April 11, 2019, https://www.federalreserve.gov/newsevents/speech/files/bowman20190411a.pdf; Lael Brainard, "What Are We Learning about Artificial Intelligence in Financial Services?", November 13, 2018, https://www.federalreserve.gov/newsevents/speech/files/brainard20181113a.pdf; Lael Brainard, "Fintech and the Search for Full Stack Financial Inclusion", October 17, 2018, https://www.federalreserve.gov/newsevents/speech/files/ brainard20181113a.pdf.

2. NARROW BANKING

Vice Chairman Quarles, as you know the Deregulation and Monetary Control Act of 1980 ("Monetary Control Act") requires the Federal Reserve to provide all Federal Reserve bank services to depository institutions. These services include granting of master accounts to those depository institutions.

a. What considerations does the Federal Reserve make when evaluating the extension of access to bank services as required under the Monetary Control Act?

A master account is a deposit account maintained at a Federal Reserve Bank. As such, master accounts are governed the Federal Reserve Act (FRA),[1] which gives Federal Reserve Banks discretion over whether to open such accounts. The FRA states that "Any Federal reserve bank *may* receive from any of its member banks, or other depository institutions ... deposits ...."[2] The courts, notably including the Supreme Court, have long held that such language denotes a discretionary power.[3] The law requires the Board to publish a set of pricing principles and a schedule of fees for Federal Reserve Bank services to depository institutions – and those enumerated services do not include opening master accounts.[4] The law does not require Reserve Banks to provide master accounts to every applicant, but rather it requires that member and nonmember banks as a group be given access to Reserve Bank services based on a common schedule of fees to be published by the Board.

b. Does the Federal Reserve evaluate the structure of institutions formed under state law that may be applying for bank services? What controls does the Federal Reserve have in place to ensure equitable evaluation across state charters?

As noted above, master accounts are governed by the FRA, which provides that Federal Reserve Banks may receive deposits from member banks "or other depository institutions." "Depository institution" means institutions that are federally insured or institutions that are eligible to make application to become federally insured.[5] The Federal Reserve evaluates the structure of state-chartered institutions to determine whether they satisfy these statutory requirements for eligibility. A Federal Reserve Bank may not grant a master account or access to Federal Reserve Bank financial services to a state-chartered depository institution that does not meet the FRA's definition of "depository institution." As noted above, a Federal Reserve Bank may, but is not required to, grant a master account or access to Federal Reserve Bank financial services to a state-chartered institution that meets the definition of "depository institution."

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[1] 12 U.S.C. § 342.
[2] Id. (emphasis added).
[3] See, e.g., Farmers and Merchants Bank v. Fed. Res. Bank of Richmond, 262 U.S. 649, 662 (1923).
[4] 12 U.S.C. §§ 248a(a)-(c).
[5] 12 U.S.C. § 461(b)(1)(A).

3. Vice Chairman Quarles, the Federal Reserve operates two facilities on its balance sheet that provides deposit and cash management services to money market mutual funds, Federal Home Loan Banks, and foreign official institutions like foreign central banks. These facilities are known as Overnight Reverse Repurchase Agreement Facility ("ON RRP") and the foreign repo pool respectively.

The Federal Reserve has noted the ON RRP rate offering is "similar to the role played by the interest rate on excess reserves for depository institutions."

a. What considerations has the Federal Reserve made in limiting the number and type of institutions that are allowed to participate in this facility?

At meetings in 2014, the Federal Open Market Committee discussed the appropriate design features of the Overnight Reverse Repurchase Agreement Facility (ON RRP), including counterparty considerations that would best allow the facility to support the implementation of monetary policy. In particular, the ON RRP facility helps to establish a floor on the level of money market rates by providing a fixed-rate investment option for entities that are eligible to participate. A firm with access to the ON RRP facility should generally be unwilling to lend to private firms at a rate below the rate at which it can place funds with the Federal Reserve in the ON RRP facility. To maximize its effectiveness as a tool for policy implementation, the set of ON RRP counterparties chosen represented the institutions that accounted for a large portion of the lending activity in overnight funding markets. Since that time, the set of counterparties is periodically updated based on an evaluation of eligibility requirements that both adds and terminates participation. The counterparty eligibility criteria are posted on the Federal Reserve Bank of New York's (FRBNY) website.[1]

b. What controls does the Federal Reserve have in place to manage use of this facility by institutions?

The Federal Reserve has multiple controls in place with respect to monitoring ON RRP counterparties' engagement with the ON RRP facility. First and foremost, the Federal Reserve evaluates continued eligibility on an ongoing basis. Institutions can be removed from the list of eligible institutions if they fail to continue to meet the eligibility requirements, become subject to regulatory or legal proceedings, are seen posing undue risk to the Federal Reserve, or do not meaningfully participate in operations. Second, even if an institution is in good standing, the Federal Reserve imposes a maximum dollar limit that each institution can deposit in the facility.

[1] *See* https://www.newyorkfed.org/markets/RRP-Counterparty-Eligibility-Criteria-2016.html.

4. The Federal Reserve stated in its December 2018 FOMC meeting minutes that the nonreserve liabilities of foreign official institutions "are not closely related to the Federal Reserve monetary policy decisions", and that the liabilities offer "social benefits" to the economy.

a. What policy reasons has the Federal Reserve relied upon in providing a foreign repo pool facility to foreign official institutions if not to accomplish monetary policy goals?

The foreign repurchase agreement pool (foreign repo pool) is a service provided by the FRBNY to foreign official and international official institutions. Foreign official and international official institutions hold cash at the Federal Reserve in order to support their dollar operational needs, to clear and settle securities in their accounts, and to address unexpected dollar shortages or exchange rate volatility. Comparable services are offered by many foreign central banks to aid the official sector with liquidity management.

b. What social benefits do these liabilities provide to the economy?

The foreign repo pool makes it easier for foreign official account holders to manage their dollar cash holdings, which are used to satisfy their dollar liquidity needs. Among these needs is the clearing and settlement of Treasury securities; some foreign official institutions purchase a sizable amount at Treasury auctions.

c. What controls does the Federal Reserve have in place to manage the use of the foreign repo pool by foreign official institutions?

The FRBNY has the discretion to manage the overall size of the foreign repo pool or individual account participation in the foreign repo pool; that is, investment access to the pool is never guaranteed. The FRBNY may choose to limit the size of or participation in the foreign repo pool based on market conditions or on other factors, such as the amount of available securities held at any time in the SOMA.

d. Has the Federal Reserve evaluated the disparity in rates that foreign official institutions receive through this facility as compared to U.S. businesses and consumers receive on deposits?

The Federal Reserve remunerates the foreign repo pool according to prevailing market rates on similar products. These rates are equivalent to other wholesale deposits, and closely follow overnight, market-based Treasury repo rates.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Bill Huizenga:

1. I, along with several of my colleagues, have had conversations with you regarding direction that the international discussions on the Insurance Capital Standard (ICS) is headed and the potential negative ramifications this proposal could have on the U.S. insurance market. On May 13, 2019, a letter was sent to you from 42 bipartisan Senators suggesting what I believe to be, the most appropriate path forward.

As the letter states, and I would like to reiterate, that you as the Chairman of the Financial Stability Board (FSB) must work with your international colleagues to ensure that the U.S. approach to insurance solvency regulation is formally recognized by the IAIS prior to its November meeting of this year.

Our system of state-based insurance regulation has served this country well for 150 years. Will you commit to ensuring recognition of the U.S. state-based regulatory system is recognized abroad and will you commit to making it your top priority?

The Financial Stability Board (FSB) is responsible for monitoring and assessing vulnerabilities affecting the global financial system, and proposing actions as necessary, to address them. As part of this role, the FSB works with the International Association of Insurance Supervisors (IAIS) in evaluating the feasibility of an ICS that could be implemented as a global standard. While the FSB has responsibility for the cross-sectoral global perspective and can have influence on actions of the individual international standard setters, the responsibility for setting international standards in insurance regulation rests with the IAIS. The U.S. members of the IAIS -- which include the Federal Reserve Board (Board), Federal Insurance Office and National Association of Insurance Commissioners (NAIC) -- have supported approaches that are appropriate for U.S. companies operating domestically and internationally. Importantly, the ICS, or any standard produced by the IAIS, is a voluntary standard that is not binding and would need to be adopted voluntarily by each member jurisdiction in accordance with applicable domestic legal requirements.

The state-based system of insurance regulation provides important protections to policyholders. We have advocated that the ICS include aggregation methods such as the Group Capital Calculation being developed by the NAIC, and the Building Block Approach, being developed by the Board. Through the development of the ICS, our goal is to have the aggregation method recognized as comparable.

2. In May 2018, the five agencies proposed significant reforms to the Volcker Rule regulations. As you noted at the time of the proposal, "experience has shown that the complexity of the rule has created compliance uncertainty for firms subject to the rule." You also indicated that the proposal was meant to "streamline the rule by eliminating or modifying requirements that are not necessary to effectively implement the statute..." The comment period for the proposal ended in the Fall and many commenters thought the proposal might unnecessarily increase the scope of the rule's coverage through the

proposed, so-called, "accounting prong" which would sweep in certain long-term holdings and other activity that is clearly beyond the scope of the statutory requirements.

In addition, many market participants noted that there were minimal specific reform proposals for the rule's restrictions on banks' ownership of certain funds and that this area needed additional clarity and simplification to allow firms to meet the rule's requirements in an efficient manner.

Given your expressed intention to reduce the complexity of the rule and provide certainty for the firms, does the Federal Reserve expect to address these concerns?

Also, do you continue to see a need for the "accounting prong" and will you be proposing specific reforms to the funds sections of the Volcker Rule?

The Board, along with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation (FDIC), Commodity Futures Trading Commission, and the Securities and Exchange Commission (the agencies), proposed amendments to the regulations implementing section 13 of the Bank Holding Company Act (the Volcker Rule), with the goal of providing banking entities with greater certainty about what activities are prohibited, and seeking to improve the effective allocation of compliance resources where possible.

The proposal requested comments on the definition of trading account to include all financial instruments marked to fair value on a recurring basis (the accounting prong), to provide more clarity and certainty to the trading account definition. The proposal also requested comment on how to tailor the regulations governing a banking entity's covered fund activities, but as you point out, included few specific proposed revisions to the implementing regulations.

On August 19, 2019, the FDIC adopted a final rule revising the Volcker Rule that addressed many of these comments. The Board will consider this final rule for adoption in the near future.

Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative McAdams:

1. During the hearing, most witnesses testified regarding the risk cyber threats and attacks could pose to the financial system broadly, and individual financial institutions specifically.

- **Will you please explain the extent prudential regulators coordinate with other sectors of the Federal government, including the national security community, to address and respond to growing cyber risks?**

The Federal Reserve Board (Board), as a member of the Financial and Banking Information Infrastructure Committee (FBIIC), coordinates on an ongoing basis with other federal government agencies, including the national security community, and the private sector, to address cyber and other operational risks that could impact the resiliency of the financial services sector. The FBIIC is chaired by the U.S. Department of the Treasury, which is the designated Sector-Specific Agency for the financial services sector with responsibility for coordination with the Department of Homeland Security and other critical infrastructure sectors. The FBIIC meets 12 times per year. Among their activities, FBIIC members participate in briefings with the national security community to share information on threats to critical infrastructure including the financial sector. FBIIC members also participate in periodic cyber-incident response exercises with representatives from regulatory agencies, the U.S. Department of Homeland Security, law enforcement, and industry, in order to explore opportunities for cooperation across the government and the private sector in the event of a significant cyber incident. Several of these exercises have included representatives from other critical infrastructure sectors such as telecommunications and energy, upon which the financial sector depends.

The Board also works with other financial regulators, through the Federal Financial Institutions Examination Council (FFIEC) and other interagency processes, to strengthen the resilience of the financial sector and reduce the potential impact of a significant cyber incident. For example, in light of the increasing volume and sophistication of cyber threats, the FFIEC developed a Cybersecurity Assessment Tool, on behalf of its members, to provide institutions with a standardized approach to identify their risks and to determine their cybersecurity maturity. In addition, the member agencies of the FFIEC rely on, and regularly update, the FFIEC Information Technology Examination Handbook, which describes appropriate practices for cyber risk management and operational resiliency that can be tailored to an individual institution's risk profile.

- **Additionally, please explain the extent your agencies coordinate with the financial sector (and other private and nonprofit entities) to address and respond to growing cyber risks?**

Due to the high degree of interconnectedness between the United States' and global financial systems, the Federal Reserve has been an active participant and leader in domestic and international forums addressing the cyber resiliency of the financial sector. As noted above, the FBIIC periodically conducts cyber exercises that include participation from the regulatory agencies, financial institutions and trade associations. These exercises have advanced incident management and information sharing protocols that encompass a large percentage of private

sector entities. Additionally, through participation in these exercises, the Federal Reserve has improved its ability to respond, in coordination with other financial regulators, to potential operational disruptions in the financial sector's critical infrastructure. These exercises also have led to the creation of a number of private sector-run and public sector-supported initiatives to enhance the sector's cyber resiliency. These include Sheltered Harbor, an organization that allows participating financial institutions to store critical customer account data in a secure industry-standard format, and the Financial Systemic Analysis and Resilience Center, an organization that proactively identifies, analyzes, and coordinates activities to mitigate systemic risk to the U.S. financial system from cyber threats.

Internationally, the Group of 7 (G7) established the Cyber Expert Group (CEG), a group of cyber security experts that meets regularly to facilitate progress on major international debates and that reports to G7 ministers and governors. This group is co-chaired by the United Kingdom and the United States. Established in November 2015, the objectives of the CEG are to (a) identify the main cyber security risks in the financial sector and (b) propose actions to be taken in this area. As part of the CEG efforts, the Federal Reserve participated and executed a simulation exercise in 2019 with member jurisdictions as well as international financial sector participants. This exercise concluded with an after-action process with findings and actionable recommendations. In addition, the Financial Stability Board (FSB), through a dedicated working group of experts, is developing effective practices relating to a financial institution's response to, and recovery from, a cyber incident. After public consultation, the FSB, which I chair, will issue a toolkit aimed at supervisors and other relevant authorities to provide financial institutions with support before and after a cyber incident. The toolkit, expected in the third quarter of 2020, will also take into account the potential cross-border nature of cyber incidents.

With regard to the payments infrastructure, the Federal Reserve is continuing its efforts to identify and provide information related to fraud risks and advance the safety, security, and resiliency of the payment system. The Federal Reserve System has collaborated with payment system stakeholders through the Secure Payments Task Force (SPTF) from 2015 to 2018. The SPTF worked to advance the understanding of the industry's most pressing payment system security issues, which were identity management, data protection, and fraud and risk information sharing. Upon the completion of the SPTF, the Federal Reserve System started its next phase of work to continue the advancement of payments security. This work aims to standardize Automated Clearing House, wire and check fraud definitions, educate the industry on different types of payments fraud, and continue industry dialogue. In addition, the Reserve Banks, as operators of critical financial services such as Fedwire, continue to advance initiatives aimed at enhancing the resiliency of the payments system. For example, the Reserve Banks have implemented risk mitigating processes, controls, and technology to reduce payments fraud emanating from weak security at the endpoint. These risk-mitigation measures align with recommendations of the Committee on Payments and Market Infrastructures, which is a committee of the Bank for International Settlements.

- **Do you believe the current levels of coordination are sufficient or could they be enhanced in any specific way?**

The Financial Services sector's resilience and cyber incident preparedness is evolving rapidly as more firms join information sharing organizations and participate in sector exercise programs, allowing them to develop and to test incident protocols and improve their processes and

practices. Through the continued work programs of interagency groups like the FFIEC and FBIIC, as well as discussions with the private sector through the Financial Services Sector Coordinating Council and the Financial Services Information Sharing and Analysis Center, the Federal Reserve continues to advocate for and support initiatives that would strengthen the financial sector's critical infrastructure.

- **Do you believe you have the statutory, regulatory, and supervisory tools necessary to ensure that cyber risks do not pose a threat to the financial system broadly, or to individual financial institutions specifically?**

The Federal Reserve has taken steps to enhance the resiliency of the financial system broadly and of individual financial institutions. Specifically, the Federal Reserve conducts cyber horizontal reviews of large banks, maintains an information technology risk examination program for regional and community banks, and has implemented cyber exam procedures pursuant to the Board's authority under the Bank Service Company Act. However, while statutory, regulatory, and supervisory tools exist, cyber threats are evolving continuously and are becoming more sophisticated. Therefore, existing tools should be periodically reviewed and updated to address emerging risks and concerns.

2. Under the recent foreign bank regulatory framework proposal ("Proposed changes to applicability thresholds for regulatory capital requirements for certain U.S. subsidiaries of foreign banking organizations and application of liquidity requirements to foreign banking organizations, certain U.S. depository institution holding companies, and certain depository institution subsidiaries"), the Federal Reserve Board (Board) would apply liquidity requirements to a U.S. intermediate holding company (IHC) based on the risk profile of a Foreign Banking Organization's (FBO) combined U.S. operations (CUSO). The Board estimates these proposed changes would represent, in the aggregate, an increase of up to 4 percent in total liquidity requirements for IHCs.

- **It is my understanding that the IHC is a distinct legal entity from the U.S. branch and funding between the entities is not fungible. Given this, has the Board evaluated - or does it plan to do so - whether efficiency would be enhanced (while properly ensuring safety and soundness) if liquidity requirements on the IHC were based on the IHC risk profile and separately on the branch based on the branch risk profile?**
- **It is my understanding that current restrictions on funding transfers between the IHC and U.S. branch include Section 23A of the Federal Reserve Act, Regulation W, asset and liquidity maintenance requirements, and Regulation YY. Does the Board believe that these existing authorities are insufficient to control funding transfers between the IHC and U.S. branches?**

On October 10, 2019, the Board finalized the foreign bank tailoring proposals ("tailoring rule") with certain targeted changes in response to comments. With respect to the issues raised in your questions, the tailoring rule generally applies the same framework to foreign banks as would apply to domestic firms, with certain adjustments to reflect the structure of foreign banks' operations in the United States. As you note, the foreign bank tailoring proposals would have applied standardized liquidity requirements to the U.S. intermediate holding company of a foreign bank based on the risk profile of the foreign bank's combined U.S. operations. The final

tailoring rule amended the proposal to apply liquidity coverage ratio standards to the U.S. intermediate holding company based solely on the risk profile of the U.S. intermediate holding company, and not on the profile of the related branch. This change simplifies and enhances the focus of the tailoring framework. The Board is still considering whether to develop a standardized liquidity requirement for the U.S. branches and agencies of foreign banking organizations, and is planning to continue discussion and evaluation of the issue with peer prudential regulators at the international level.

<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative William Posey:</u>

Ten years later we are still learning from the financial crisis. How we got to that point is one aspect. Another, is how the Federal Reserve brought the crisis to an end.

A growing literature cites the Fed's role in stabilizing asset prices. The Fed bought private securities — largely Mortgage Backed Securities (MBS), and expanded its balance sheet dramatically.

At one point, the Fed was purchasing 90% of new mortgage backed securities. These assets had collapsed in value, and no longer provided reliable collateral to fund them.

That's the essence of the liquidity crisis. The Fed buying these assets was a little like the Agriculture Department of old propping up commodity prices.

In the panic, we see the Fed backstopping assets. We seem to have placed a lot of emphasis on the Fed backstopping financial institutions and therefore we talk about "global systemically important banks" and "too big to fail."

1. Perhaps our emphasis ought to be on backstopping asset markets gone awry. Disregarding how we got to the housing collapse, and how we arrived at the financial crisis, can you please share with us whether or not the size of banks matter? If we would have had a situation with the same asset market demise and much smaller institutions, wouldn't the challenge have been at least as great to bring the crisis under control as it was with the Globally Systemic Important Banks?

The dynamics of a liquidity crisis are complex and have involved both large and small financial institutions in the past. Contagion among financial institutions can be prompted by a number of factors, including exposure to similar asset classes, interconnectedness among financial institutions, and similarity of business models. The savings and loan crisis of the 1980s, involving many relatively small institutions, is a case in point. Nonetheless, while these elements are not isolated to large banks, large banks tend to be more interconnected with one another than smaller firms and can have exposures, which are large on an absolute basis, that make them more susceptible to these risks. As a result, and relative to smaller banks, contagion may spread more rapidly and severely when larger banks are in distress or fail.

2. Some economists believe the emphasis on capital requirements conditioned on perceptions from the financial crisis have unduly restricted capital market expansion and really don't provide a great deal of protection against a liquidity-driven downward spiral in asset prices. Capital — even if insufficient — didn't really go very far in the crisis. The commercial banking system works because we have a clearing system of short-term credit to meet liquidity constraints by banks borrowing overnight when they are short and lending when they are long.

Do we need to think about policies or measures to better assure the ability of securities dealers and investment bankers to rollover their credit and keep the asset markets stable and avoid the kinds of liquidity instabilities we saw in the crisis?

Post-crisis regulatory and supervisory reforms have generally required large financial institutions to cover funding risk by requiring firms to either extend the maturity tenor of their funding transactions or hold liquidity buffers against the potential inability to rollover maturing transactions. In particular, large bank holding companies are required to hold liquidity to meet the Federal Reserve Board's (Board) Liquidity Coverage Ratio (LCR) rule. A holding company's LCR includes the liquidity risks of any broker-dealer subsidiaries and requires the firm to hold a liquid asset buffer to meet potential liquidity needs in a period of stress, including those associated with their securities dealing and investment banking operations.

3. Are current bank capital requirements based on Basel and other research really providing risk reduction benefits that exceed their prospective costs in terms of restricting credit and capital markets?

Promoting the safety and soundness of individual financial institutions is critical to maintaining the stability of the U.S. financial system and the broader economy. Following the financial crisis and consistent with the Basel III standards, which the Board helped to develop, the Board, along with other regulatory agencies, has substantially strengthened regulatory capital requirements for U.S. banks.

Regulatory capital requirements for banks are calibrated to reduce both the probability that an individual bank will fail, and—from a macroprudential perspective—the probability of future financial crises and the substantial negative economic effects that they generate. Extensive economic analysis is conducted by the Board in the development of regulatory capital requirements, particularly given that their calibration is integral to both the safety and soundness of individual banking organizations and to ensure that they do not unduly reduce the provision of credit to the economy. Recent academic and Board staff research has concluded that, at current levels, the benefits of bank capital requirements exceed their costs, notably in the form of a more stable and resilient U.S. financial system.

4. Legislation under consideration in this hearing would expand oversight by making additional hearings mandatory for the prudential regulators.

Shouldn't we hold these hearings when events prompt them rather than blindly require them at recurring intervals?

Can we rely on a process of written reports with appropriate issues focus from you and our own surveillance of the financial system to alert us to the need for oversight hearings?

Do you have any specific ideas in this regard?

The Board takes seriously its responsibilities to provide testimony, reports, and other information as requested and is committed to doing so in a complete and timely manner. In the areas of monetary policy and supervision and regulation, the Federal Reserve reports biannually to Congress on recent economic developments and its plans for monetary policy, as well as the condition of the nation's banking institutions and its regulatory and supervisory agenda.

It is a decision of each committee of jurisdiction to determine how to carry out its legislative responsibilities. In addition to a number of reports that the Board provides to Congress at regular intervals, in 2018, the Board began issuing an annual financial stability report. This report summarizes the Board's framework for assessing the resilience of the U.S. financial system and presents the Board's current assessment. Also in 2018, the Board began publishing semiannually the Supervision and Regulation Report, which provides periodic information about banking conditions and the Federal Reserve's supervisory and regulatory activities.[1] By publishing these reports, the Board intends to promote public understanding and increase transparency and accountability for the Federal Reserve's views on this topic.

[1] See https://www.federalreserve.gov/publications/financial-stability-report.htm.

<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Denver Riggleman:</u>

1. In July 2018 the Department of Treasury issued a report titled "A Financial System That Creates Economic Opportunities, Nonbank Financials, Fintech, and Innovation." The report states, "Treasury agrees with the Federal Reserve's policy criteria for introducing a new payment service – namely, that the Federal Reserve must":

> **1. expect to achieve full cost recovery in the long run;**
> **2. expect the service to provide a clear public benefit, including improving the effectiveness of markets, reducing the risk in payments, or improving efficiency of the payments system; and**
> **3. conclude that the service should be one that other providers alone cannot expect to provide with reasonable effectiveness, scope, and equity.**

In his testimony before the House Financial Services Committee in February 2017, Federal Reserve Chairman Powell, in response to a question on the Fed's faster payment initiative, stated that, before entering this market, the Federal Reserve must first find that, "[it is] not something that the private sector can adequately provide."

With In light of the development and implementation of The Clearing House's Real-Time Payment (RTP) system, the Treasury Report's recommendations, and Chairman Powell's comments, how has the Fed justified a conclusion that "other providers", or the private sector, has failed to provide reasonable effectiveness, scope, and equity in the faster payments arena?

The Board announced on August 5, 2019, that the Reserve Banks will develop a new real-time payment and settlement service, called the FedNow^{SM} Service, to support faster payments in the United States.

In assessing its criteria for new payment services, the Board considers input from the public, historical experience, and its own analysis to assess whether such services can be expected to generate public benefits that private-sector services alone may be unable to achieve.[2] Although my fellow governors concluded that the development of the FedNow Service is appropriate at this time, I did not see a strong justification for the Federal Reserve to move into this area and crowd out innovation when viable private-sector alternatives are available. As a result, I voted against this action.

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[2] The Board considered whether private-sector real-time gross settlement (RTGS) services for faster payments alone could be expected to provide an infrastructure for faster payments with reasonable effectiveness, scope, and equity, and further, if private-sector services are likely to face significant challenges in extending equitable access. The Board also considered whether the development of the FedNow Service will likely yield clear and substantial benefits to the safety and efficiency of faster payments in the United States.

2. Moreover, the Monetary Control Act requires, in essence, that the Federal Reserve to show identify a market failure prior to providing a new service like that proposed in the Fed's Oct. 2018 Request for Information.

Aside from the Treasury's recommendations and Chairman Powell's comments, do you believe the Fed has the adequately subscribed to complied with the statutory obligations set forth by in the Monetary Control Act?

And if so, what information and data did the Federal Reserve use to draw such conclusions?

Please see the response to Question 1.

3. In addition, the Federal Reserve's own policy statement ("The Federal Reserve in the Payments System") requires that several "criteria must be met" as the Federal Reserve "considers the introduction of new services," including that any new Federal Reserve service "be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity."

Please explain, in detail, why you appear to have concluded that the private sector "alone cannot be expected to provide [real-time payments] with reasonable effectiveness, scope, and equity."

If you take the view that the Federal Reserve need not make this determination until such time as it affirmatively decides to provide this new service, I would assume that the Board has undertaken at least a preliminary assessment of the private sector's existing role in the provision of real-time payments.

Please describe, in detail, the scope, methodology, and conclusions of this preliminary assessment.

Please see the response to Question 1.