

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

November 6, 2020

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: November 12, 2020, Full Committee Hearing entitled, “Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic”

The full Committee will hold a hearing entitled, “Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic,” on Thursday, November 12, 2020, at 12:00 p.m. on the virtual meeting platform Cisco Webex. There will be one panel with the following witnesses:

- **Mr. Brian Brooks**, Acting Comptroller of the Currency, Office of the Comptroller of the Currency
- **The Honorable Rodney Hood**, Chairman, National Credit Union Administration
- **The Honorable Jelena McWilliams**, Chairman, Federal Deposit Insurance Corporation
- **The Honorable Randal Quarles**, Vice Chairman of Supervision, Board of Governors of the Federal Reserve System

Overview

The responsibility for prudential regulation of insured depository institutions is divided among four Federal regulators consisting of the Board of Governors of the Federal Reserve System (Federal Reserve or the Fed), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA).¹ Section 1108 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created the position of Vice Chairman for Supervision for the Federal Reserve and requires the Vice Chairman to testify before the Committee at semi-annual hearings.² The FDIC, OCC, and NCUA do not have such mandatory testimony requirements. Most recently, the Committee held a bipartisan roundtable on May 13, 2020, where the four prudential regulators provided an update on their efforts to respond to the COVID-19 pandemic.³ This hearing memo will briefly highlight background on depository institutions, recent supervisory and regulatory developments as well as background on diversity in the banking sector.

Background on Depository Institutions

According to the FDIC, there were 5,066 FDIC-insured banks as of June 30, 2020. In the aggregate, these banks made nearly \$19 billion in profits for the quarter and held \$21.1 trillion in total assets, representing an increase of \$2.9 trillion in total assets (15.9 percent) compared to the second quarter of 2019. The aggregate amount of loans and leases outstanding held by these banks rose by \$696 billion (6.6 percent) to \$10.9 trillion compared to the previous year. Most of these institutions are community

¹ For more information, see Congressional Research Service (CRS), “[Banking Policy Issues in the 116th Congress](#),” Feb. 21, 2019; and CRS, “[Introduction to Bank Regulation: Credit Unions and Community Banks: A Comparison](#),” Dec. 14, 2018.

² 12 U.S.C. § 247b.

³ See House Committee on Financial Services, [Update from Prudential Regulators](#) (May 13, 2020).

banks; for example, 4,918 of these banks held less than \$10 billion in total assets (97 percent).⁴ According to the NCUA, there were 5,164 NCUA-insured credit unions with 122.3 million members as of June 30, 2020. These credit unions held a combined \$1.75 trillion in total assets, representing an increase of \$229 billion (15.1 percent) in total assets compared to the second quarter of 2019. Total loans outstanding held by these credit unions increased \$70 billion (6.6 percent) over the year to \$1.1 trillion. Most credit unions are small financial institutions; for example, 4,807 of these credit unions held less than \$1 billion in total assets (93 percent), and the average credit union held \$339 million in total assets at the end of the second quarter.⁵

Diversity in Banking

There are 143 minority depository institution (MDI) banks and 514 MDI credit unions, which represents a decline of roughly one-third of these institutions over the past decade.⁶ MDIs, as well as community development financial institutions (CDFIs) have played a key role supporting minority communities hardest hit by the pandemic.⁷

In February 2020, Committee staff released a report on the diversity and inclusion data and practices at America's largest banks.⁸ The report noted that banks generally lacked diversity in their senior ranks, corporate boards, and provided limited data on their investment with diverse-owned firms. To improve accountability for tangible diversity and inclusion results, Committee staff recommended that, among other things, Congress consider legislation that would require banks and other financial institutions to disclose their diversity data to their respective regulators and the public.

Pandemic Response by Prudential Regulators

In early March 2020, banking regulators began encouraging financial institutions to work with customers affected by the COVID-19 pandemic.⁹ In addition, the agencies have issued multiple guidance on how banks should report on and account for loans that become nonperforming during the pandemic. A March 22, 2020 interagency statement clarified that loan modifications should not automatically be characterized as troubled debt restructurings (TDRs)—an accounting standard indicating the loan is impaired, which requires additional loss reserves be held against it.¹⁰ Subsequently, the CARES Act was enacted, and Section 4013 requires federal depository regulators to allow lenders to suspend certain accounting requirements related to loan modifications and TDR classification.¹¹ Moreover, Section 4022 of the CARES Act establishes consumer rights to be granted forbearance for federally insured mortgages. On April 3, 2020, bank regulators issued guidance encouraging mortgage servicers to place consumers in short-term forbearance programs, consistent with the CARES Act provision, stating that they are taking a

⁴ FDIC, [Quarterly Banking Profile – Second Quarter 2020](#) (Jun. 30, 2020).

⁵ NCUA, [Quarterly Credit Union Data Summary – 2020 Q2](#) (Jun. 30, 2020).

⁶ See House Committee on Financial Services, [Hearing on Promoting Inclusive Lending During the Pandemic: Community Development Financial Institutions and Minority Depository Institutions](#) (Jun. 3, 2020).

⁷ See House Committee on Financial Services, [Waters and Meeks Introduce the “Promoting and Advancing Communities of Color Through Inclusive Lending Act”](#) (Aug. 8, 2020).

⁸ House Committee on Financial Services, [Diversity and Inclusion: Holding America's Large Banks Accountable](#) (February 2020).

⁹ For example, see OCC, [Agencies Encourage Financial Institutions to Meet Financial Needs of Customers and Members Affected by Coronavirus](#) (Mar. 9, 2020). Also see Congressional Research Service (CRS), [COVID-19: The Financial Industry and Consumers Struggling to Pay Bills](#) (Mar. 31, 2020).

¹⁰ Federal Reserve, OCC, FDIC, CFPB, CSBS, [Agencies Provide Additional Information to Encourage Financial Institutions to Work with Borrowers Affected by COVID-19](#) (Mar. 22, 2020).

¹¹ Federal Reserve, OCC, FDIC, CFPB, CSBS, [Agencies Issue Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus](#) (Apr. 7, 2020).

“flexible supervisory and enforcement approach” to ensure that servicers are able to do this without further straining their operational capacity.¹²

Depository institutions are subject to “safety and soundness” regulations, which include capital and liquidity regulatory requirements. Prudential regulators have made a series of adjustments to these requirements ostensibly to ensure financial institutions can meet the needs of their customers during the pandemic, however, the policy tradeoff is that these changes could negatively affect these institutions’ safety and soundness at a time when they face the prospect of rising default rates and declining asset values. Under the Dodd-Frank Act and Basel III – an international accord that sets standards for bank regulation – the largest banks face more complex and stringent regulations than other banks.¹³ Regulators have delayed or relaxed a number of regulations that apply to the largest banks in response to COVID-19. For example, the Fed relaxed the supplementary leverage ratio (SLR) rule that applies to the largest banks by exempting certain assets from the banks’ exposure measures.¹⁴ The SLR change is intended to address concerns about rapidly growing bank balance sheets and to mitigate the risk of a sudden and correlated increase in capital requirements. However, such exemptions reduce the amount of capital large banks are required to maintain. Furthermore, while the Fed has constrained some share buybacks and dividend payments by the largest banks, they have not prohibited all dividend payments. Experts have noted lower capital requirements and continued dividend payments weaken the safety and soundness of the banking system at a critical time.¹⁵

Related to the issue of depository institutions balance sheets growing during the pandemic crisis, banks and credit unions have been key lenders of the Paycheck Protection Program (PPP), providing more than \$525 billion in forgivable loans to small businesses. While PPP loans are guaranteed by the Small Business Administration (SBA), PPP loans remain on a bank’s balance sheet until the loan has been forgiven. Additionally, NCUA made modifications so that credit unions that temporarily fall below well-capitalized levels will not have to retain as much of their earnings as they generally would. Credit unions that temporarily fall below adequately capitalized levels will be allowed to file a simpler capital restoration plan than generally required.¹⁶ Section 4016 of the CARES Act temporarily grants access to the Central Liquidity Facility (CLF) for a larger set of credit unions, and increases the CLF borrowing authority.¹⁷

Other Supervisory and Regulatory Developments

Enhanced Prudential Standards. Regulators have made additional rulemakings regarding enhanced prudential standards over the past year unrelated to the pandemic. For example, in March 2020, the Fed finalized a rule to combine elements of the stress testing regime and the Basel III capital requirements to create a new stress capital buffer (SCB) requirement.¹⁸ Fed Governor Lael Brainard voted against the final rule on the grounds it would substantially reduce large bank capital requirements.¹⁹ In

¹² CFPB, Fed, FDIC, NCUA, OCC, and Conference of State Bank Supervisors, [Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency](#) (Apr. 3, 2020).

¹³ CRS, [Enhanced Prudential Regulation of Large Banks](#) (May 6, 2019).

¹⁴ Federal Reserve, [Federal Reserve Board announces temporary change to its supplementary leverage ratio rule to ease strains in the Treasury market resulting from the coronavirus and increase banking organizations’ ability to provide credit to households and businesses](#) (Apr. 1, 2020). Also see Federal Reserve, FDIC, and OCC, [Regulators temporarily change the supplementary leverage ratio to increase banking organizations’ ability to support credit to households and businesses in light of the coronavirus response](#) (May 15, 2020).

¹⁵ See Gregg Gelzinis, [Bank Capital and the Coronavirus Crisis](#), Center for American Progress (May 12, 2020).

¹⁶ NCUA, [NCUA Board Approves Changes to Prompt Corrective Action Requirements](#) (May 21, 2020).

¹⁷ NCUA, [NCUA Board Approves Changes to Central Liquidity Facility](#) (Apr. 13, 2020).

¹⁸ Federal Reserve, [Federal Reserve Board Approves Rule To Simplify Its Capital Rules For Large Banks, Preserving The Strong Capital Requirements Already In Place](#) (Mar. 04, 2020).

¹⁹ Federal Reserve, [Statement by Governor Brainard](#) (Mar. 4, 2020).

October 2020, regulators finalized the net stable funding ratio (NSFR) rule and total loss absorbency capacity (TLAC) rule that apply to the largest banks.²⁰ The NSFR rule requires large banks to have a minimum amount of stable funding backing their assets over a one-year horizon. The TLAC rule requires banks to hold a minimum amount of capital and long-term debt at the holding company level so that these equity and debt holders can absorb losses in the event of the firm's insolvency. FDIC Board Member Marty Gruenberg opposed both rules, noting that the NSFR rule was substantively weakened and narrowed compared to the proposed rule,²¹ while the TLAC rule was narrowed to exempt 10 large U.S. and foreign banks with large U.S. operations.²²

Community Reinvestment Act. On May 20, 2020, the OCC finalized a rule substantially revising the Community Reinvestment Act (CRA), altering how OCC regulated banks would be assessed for compliance with the law.²³ The Fed and FDIC did not sign on to the OCC's final rule, which was criticized by a wide range of stakeholders.²⁴ In September, the Fed advanced its own notice of proposed rulemaking on modifications to the CRA utilizing a different approach,²⁵ which has generated some initial positive feedback from community and civil rights groups, as well as banking trades.²⁶

Volcker Rule. Following a October 2019 rulemaking where prudential regulators, along with the Securities and Exchange Commission (SEC) and Commodity Future Trading Commission (CFTC), modified the compliance requirements for the Volcker Rule's proprietary trading ban,²⁷ these regulators finalized a second rule in June 2020 modifying the Volcker Rule's sponsorship restrictions.²⁸ Governor Brainard opposed the rule on the grounds that it "would open the door for firms to invest in a broad set of venture capital funds without limit...(and) to invest without limit in credit funds."²⁹

Swap Margin Rule. The Dodd-Frank Act required most swaps to be cleared, with margin required. Margin is also required for uncleared swaps involving financial institutions whose primary regulator included one of the three banking regulators. Initial margin is the amount of margin posted when the swap is entered into, while variation margin is changes in the amount of margin posted over time to reflect changes in the underlying swap's value. In June 2020, these regulators issued a final rule modifying the 2015 swap margin rule, exempting uncleared swaps with inter-affiliates from initial margin requirements, while keeping variation margin requirements.³⁰ Fed Governor Brainard argued that the rule would significantly weaken a key capital requirement for the largest banks.³¹

Bank Partnerships and Fintech Charters. At a recent hearing, the Committee's Task Force on Financial Technology examined regulatory developments relating to various fintech charters in the

²⁰ Federal Reserve, OCC, and FDIC, [Agencies finalize rule to reduce the impact of large bank failures](#) (Oct. 20, 2020), and Federal Reserve, OCC, and FDIC, [Agencies issue final rule to strengthen resilience of large banks](#) (Oct. 20, 2020).

²¹ FDIC, [Statement by Martin J. Gruenberg, Member, FDIC Board of Directors on the Final Rule: NSFR](#) (Oct. 20, 2020).

²² FDIC, [Statement by Martin J. Gruenberg, Member, FDIC Board of Directors on the Final Rule: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of G-SIBs](#) (Oct. 20, 2020).

²³ OCC, [OCC Finalizes Rule to Strengthen and Modernize Community Reinvestment Act Regulations](#) (May 20, 2020).

²⁴ See National Community Reinvestment Coalition (NCRC), [Analysis Of The OCC's Final CRA Rule](#) (Jun. 15, 2020).

²⁵ Federal Reserve, [Federal Reserve Board issues Advance Notice of Proposed Rulemaking on an approach to modernize regulations that implement the Community Reinvestment Act](#) (Sep. 21, 2020).

²⁶ See NCRC, [NCRC Initial Analysis of Federal Reserve's ANPR on the Community Reinvestment Act: A Step Forward But Needs to be More Rigorous](#) (Oct. 16, 2020), and ICBA, [Statement on Fed CRA Notice](#) (Sep. 21, 2020).

²⁷ Federal Reserve, OCC, FDIC, SEC, and CFTC, [Agencies Finalize Changes to Simplify Volcker Rule](#) (Oct. 8, 2019).

²⁸ Federal Reserve, OCC, FDIC, SEC, and CFTC, [Financial regulators modify Volcker rule](#) (Jun. 25, 2020).

²⁹ Federal Reserve, [Statement by Governor Brainard](#) (Jun. 25, 2020).

³⁰ Federal Reserve, OCC, FDIC, Farm Credit Administration, and Federal Housing Finance Agency, [Agencies Finalize Amendments To Swap Margin Rule](#) (Jun. 25, 2020).

³¹ Federal Reserve, [Statement by Governor Lael Brainard](#) (Jun. 25, 2020).

banking sector, including for Industrial Loan Companies (ILCs) and OCC’s proposed fintech and payment charters.³² The Task Force also examined rent-a-bank schemes that may be advanced through bank partnerships as part of several rulemakings by the FDIC and OCC. Subsequently, the OCC finalized a rule to clarify when banks are the “true lender” in relation to third parties they may partner with, however consumer groups criticized the rule, arguing it will allow predatory lenders to evade state usury limits.³³

Ex-Offenders with Minor Offenses Seeking Employment. In July 2020, the FDIC approved a final rule to revise and incorporate into the agency’s regulations a longstanding Statement of Policy (SOP) related to Section 19 of the Federal Deposit Insurance Act, which provides criteria for individuals seeking employment in the banking industry with certain minor criminal offense.³⁴ This follows the NCUA Board approving a final interpretive ruling and policy statement last year allowing people convicted of certain minor offenses to return to work in the credit union industry without applying for the Board’s approval.³⁵

Legislation

- **H.R. 6789, Access to Credit for Small Businesses Impacted by the COVID-19 Crisis Act (Sherman)**, which would extend the CARES Act expansion of NCUA’s Central Liquidity Facility to December 2021 and provide an exemption to the member business lending cap for certain credit unions.
- **H.R.7946, Federal Reserve Racial and Economic Equity Act (Waters)**, which would require the Fed to carry its duties in a manner that would help eliminate racial and ethnic disparities in the economy.
- **H.R.7993, Promoting and Advancing Communities of Color through Inclusive Lending Act (Waters)**, which would make reforms to strengthen and provide investments in MDIs and CDFIs.
- **H.R. 8675, Preventing Regulatory Penalties for PPP Lenders Act (Loudermilk)**, which would exempt all PPP loans from determining asset thresholds and categories under various regulations that apply to depository institutions and their holding companies with less than \$15 billion in total assets.
- **H.R. ____, Asset Calculation Flexibility to Support Small Businesses Act**, which would provide a temporary exemption, through March 31, 2021, for PPP loans that are in the process of being forgiven from regulatory and supervisory requirements when calculating a depository institution’s total assets.
- **H.R. ____, Promoting Safety and Soundness during the Pandemic Act**, which would prohibit G-SIBs from repurchasing shares or paying dividends during the pandemic.
- **H.R. ____, Protecting Consumers and Small Businesses through Forbearance Act**, which would extend the CARES Act provision related to the accounting treatment of troubled debt restructurings for financial institutions, and provide for consumer forbearance, through June 2021.
- **H.R. ____, Expanding Opportunities in Banking Act**, which would expand employment opportunities at banks and credit unions for certain formerly incarcerated individuals.
- **H.R. ____, Federal Reserve Bank Board Diversity Act (Beatty)**, which would require the consideration of at least one individual reflective of gender diversity and one individual reflective of racial or ethnic diversity when filling Federal Reserve bank board of directors’ vacancies.
- **H.R. ____, Diversity in Financial Regulatory Advisory Committees Act**, which would require reporting of advisory committee demographics and the consideration of at least one gender and racially or ethnically diverse individual when filling advisory committee vacancies at certain financial regulatory agencies.

³² See Task Force on Financial Technology, House Committee on Financial Services, [Hearing on License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age](#) (Sep. 29, 2020).

³³ See NCLC, [New OCC Rule Protecting Predatory Lenders Could Face Legal Challenge](#) (Oct. 27, 2020)

³⁴ FDIC, [FDIC Final Rule Revises and Codifies Policy to Allow Greater Employment Opportunities for Individuals with Certain Minor Criminal Offenses on Their Records](#) (Jul. 24, 2020).

³⁵ NCUA, [Board Approves Second-Chance Policy Changes](#) (Nov. 21, 2019).