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May 14, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: May 19, 2021, Full Committee Hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"

The full Committee will hold a hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions" on Wednesday, May 19, 2021, at 10:00 AM ET on the virtual meeting platform Cisco Webex. There will be one panel with the following witnesses:

- **The Honorable Todd Harper,** Chairman, National Credit Union Administration
- **Mr. Michael Hsu,** Acting Comptroller of the Currency, Office of the Comptroller of the Currency
- **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

Prudential regulation of insured depository institutions is divided among four Federal regulators consisting of the Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA).[1,2] According to the FDIC, there were 5,001 FDIC-insured banks as of December 31, 2020. Most of these institutions are community banks; for example, 4,850 of these banks held less than $10 billion in total assets (97 percent). Between the end of 2019 and the end of 2020, these banks made $147.9 billion in profits and total assets rose by more than $3.2 trillion (17.4% increase) to nearly $21.9 trillion. Total loans and leases outstanding held by these banks at the end of 2020 increased to $10.8 trillion (3.3% increase).[3] According to the NCUA, there were 5,099 NCUA-insured credit unions with 124.9 million members as of December 31, 2020. Most credit unions tend to be similar in size to small banks. At the end of

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[1] For more information, *see* Congressional Research Service (CRS), *Banking Policy Issues in the 117th Congress* (Mar. 2, 2021); CRS, *Bank Supervision by Federal Regulators: Overview and Policy Issues* (Dec. 28, 2020); and CRS, *Introduction to Bank Regulation: Credit Unions and Community Banks: A Comparison*, (Dec. 14, 2018).

[2] Section 1108 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) created the position of Vice Chairman for Supervision for the Fed and requires the Vice Chairman to testify before the Committee at semi-annual hearings. The FDIC, OCC, and NCUA do not have such mandatory testimony requirements. Most recently, the Committee held a hearing on November 12, 2020, where the four agencies provided an update on their efforts to respond to the COVID-19 pandemic.

[3] FDIC, *Quarterly Banking Profile* (Dec. 31, 2020).

2020, 90% of credit unions had less than $689 million in assets.[4] During 2020, credit union assets increased 17.7% to $1.84 trillion. Total loans outstanding held by these credit unions increased to $1.16 trillion (4.9% increase).

Diversity in Banking

As required by Dodd-Frank, each prudential regulator maintains an Office of Minority and Women Inclusion (OMWI) and reports annually to Congress on their activities.[5] Additionally, in February 2020, Committee staff released a report on the diversity and inclusion data and practices at America's largest banks.[6] 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. Furthermore, as of December 31, 2020, there were 142 minority depository institution (MDI) banks and 520 MDI credit unions,[7] which represents a decline of roughly one-third of these institutions over the past decade.[8] As part of the Consolidated Appropriations Act for 2021 enacted into law in December 2020, Congress provided $12 billion in capital investments and grants to support MDIs and CDFIs and the communities they serve.[9]

Pandemic Response by Prudential Regulators

At the onset of the COVID-19 pandemic, banking regulators began encouraging financial institutions to work with customers affected by the COVID-19 pandemic.[10] 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.[11] 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.[12] 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 "flexible supervisory and enforcement approach" to ensure that servicers are able to do this without further straining their operational capacity.[13]

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[4] NCUA, *Quarterly Data Summary Report* (Dec. 31, 2020).

[5] See FDIC, *OMWI Reports*; Fed, *Report to the Congress on the Office of Minority and Women Inclusion* (Mar. 2021); NCUA, *NCUA Releases Office of Minority and Women Inclusion Annual Report to Congress*; OCC, *OMWI Publications* (accessed May 12, 2021).

[6] Committee, *Diversity and Inclusion: Holding America's Large Banks Accountable* (February 2020).

[7] *See* FDIC, *MDI Program* (Dec. 31, 2020); and NCUA, *Minority Depository Institution Preservation* (Dec. 31, 2020)

[8] *See* Subcommittee on Consumer Protection and Financial Institutions hearing, *An Examination of Regulators' Efforts to Preserve and Promote Minority Depository Institutions* (Nov. 20, 2019).

[9] See House Committee on Financial Services, *One pager on the provisions providing Emergency Support for CDFIs and MDIs in the December COVID-19 stimulus package* (accessed May 12, 2021).

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

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

[12] Fed, 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).

[13] 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).

Under the Dodd-Frank Act, the largest banks face more complex and stringent regulations than other banks.[14] Regulators have delayed or relaxed a number of regulations that apply to the largest banks in response to COVID-19. However, experts cautioned that lower capital requirements, along with continued dividend payments weaken the safety and soundness of the banking system at a critical time.[15] In December 2020, the Fed lifted temporary prohibitions it has imposed on large banks' from conducting share buybacks or increasing dividend payments, drawing a dissent from Governor Brainard, who noted that banks' breached regulatory minimums for capital under certain stress test scenarios.[16] Remaining restrictions on banks' capital distributions are scheduled to expire on June 30, pending stress test results.[17] Earlier in the pandemic, the Fed relaxed the supplementary leverage ratio (SLR) rule that applies to the largest banks by exempting certain assets from the banks' exposure measures,[18] however on March 19, 2021, the Fed announced that it would not extend the temporary relaxation of SLR.[19]

In March 2021, NCUA made modifications so that credit unions that temporarily fall below adequately capitalized levels due to an influx of deposits from stimulus payments will be allowed to file a simpler capital restoration plan than generally required.[20] In December 2020, Congress extended Section 4016 of the CARES Act which temporarily grants access to the Central Liquidity Facility (CLF) for a larger set of credit unions, and increases the CLF borrowing authority.

Other Supervisory and Regulatory Developments

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.[21] The Fed and FDIC did not sign on to the OCC's final rule, which was criticized by a wide range of stakeholders.[22] In September, the Fed advanced its own notice of proposed rulemaking on modifications to the CRA utilizing a different approach.[23]

Fair Access Rule. In November 2020, the OCC proposed a rule guaranteeing so-called "fair access" to lending to entire business sectors, such as fossil fuel companies and gun manufacturers. This requirement would apply even where the lending in question exacerbates financial stability risks that regulators have flagged, such as climate change.[24] The proposed rule, which was slated to take effect on April 1, 2021, was placed on pause on January 28, 2021.[25]

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[14] CRS, *Enhanced Prudential Regulation of Large Banks* (May 6, 2019).
[15] *See* House Committee on Financial Services, *Waters Urges Regulators Not to Weaken Big Bank Leverage and Capital Requirements* (Mar. 9, 2021).
[16] New York Times, *Banks can resume buybacks and pay dividends if they're profitable, Fed says,* (Dec. 18, 2020).
[17] Fed, *Federal Reserve announces temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, based on results from upcoming stress test,*(Mar. 25, 2021).
[18] Fed, *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).
[19] Fed, *Temporary supplementary leverage ratio changes to expire as scheduled,* (Mar. 19, 2021).
[20] NCUA, *NCUA Board Renews Prompt Corrective Action Relief* (Apr. 16, 2021).
[21] OCC, *OCC Finalizes Rule to Strengthen and Modernize Community Reinvestment Act Regulations* (May 20, 2020).
[22] *See* National Community Reinvestment Coalition (NCRC), *Analysis Of The OCC's Final CRA Rule* (Jun. 15, 2020).
[23] Fed, *Federal Reserve Board issues Advance Notice of Proposed Rulemaking on an approach to modernize regulations that implement the Community Reinvestment Act* (Sep. 21, 2020).
[24] Fed, *Financial Stability Report,* (Nov. 2020).
[25] OCC, *OCC Puts Hold on Fair Access Rule* (Jan 28, 2021).

Fintech Charters and Bank Partnerships. Technology is rapidly affecting the financial system, with online lenders, payment processors, and other fintech companies increasingly growing in market share.[26] Consequently, many of these companies desire a national charter that eases the state-by-state burden and allows them to perform bank-like activities, with the OCC and the FDIC in particular allowing firms to engage in banking activities while being subject to less regulations and supervision.[27] Some companies have obtained state-issued industrial loan company (ILC) charters to originate loans, process payments, and take deposits insured by the FDIC.[28] ILCs are controversial because under the Banking Holding Company Act (BHCA), they are exempt from the definition of a bank, allowing a degree of blending of a banking enterprise and a commerce enterprise.[29] On Dec. 15, 2020, the FDIC issued a final rule clarifying process and safety and soundness requirements for ILC deposit insurance applications, but did not address the risks posed by allowing the blending of commerce and banking and a lack of Federal Reserve supervision.[30]

On Nov. 17, 2020, former Acting Comptroller of the Currency Brian Brooks announced that National Trust Charters would be used as a pathway for banks that specialize in cryptocurrency and/or assets.[31] Since then, the OCC has given three companies preliminary conditional approval for a National Trust Charter.[32] As fintech firms seek access to the Fed's payment systems, the Fed proposed payment account access guidelines that previously had been handled in an *ad hoc* way between Federal Reserve Banks. The proposed guidelines would grant access to firms that are found to be in "sound financial condition."[33]

Cryptocurrency and Digital Assets. Regulators are grappling with how to oversee digital asset, including cryptocurrencies, non-fungible tokens (NFTs), stablecoins, and other digital representations of value made possible by cryptography and distributed ledger technology (DLT.)[34] In January 2021, the OCC published Interpretive Letter 1174 that allows banks to use new technologies, such as DLT and stablecoins, to perform bank-permissible functions like payment activities.[35]Additionally, the Federal Reserve Bank of Boston has partnered with MIT to create a central bank digital currency pilot project that may be unveiled in 2021.[36]

Algorithmic Accountability. Due to companies continuing to expand their use of these technologies with little oversight, the prudential regulators, alongside the Consumer Financial Protection Bureau, put out a request for information on the use of artificial intelligence, including machine

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[26] *See* Subcommittee on Consumer Protection and Financial Institutions, hearing entitled, "Banking Innovation or Regulation Evasion? Exploring Modern Trends in Financial Institution Charters (Apr. 15, 2021).
[27] OCC, OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies (Jul. 31, 2018); See also FDIC, FDIC Approves the Deposit Insurance Application for Nelnet Bank, Salt Lake City, Utah Area (Mar. 18, 2020).
[28] CRS, Industrial Loan Companies (ILCs): Background and Policy Issues (Updated Sept. 9, 2020) (R46489).
[29] *Id.*
30 Dodd-Frank required the FDIC to mandate parent companies of ILCs to "serve as a source of financial strength" to the depository institution; 12 U.S.C. §1831o-1(b); FDIC, FDIC Approves Rule to Ensure Safety and Soundness of Industrial Banks (Dec. 15, 2020). See also CRS, Banking Policy Issues in the 117th Congress (Mar. 2, 2021).
[31] Forbes, OCC Chief Brian Brooks Says Payments Charter Is Ready, More Crypto Banks Coming Soon (Nov. 17, 2020).
[32] OCC, OCC Conditionally Approves Conversion of Anchorage Digital Bank (Jan. 13, 2021); *See also* OCC, OCC Conditionally Approves Conversion of Protego Trust Bank (Feb. 5, 2021); *See also* OCC, OCC Conditionally Approves Chartering of Paxos National Trust.
[33] Fed, *Federal Reserve Board invites public comment on proposed guidelines to evaluate requests for accounts and payment services at Federal Reserve Banks*, (May 5, 2021).
[34] *See* CRS, Digital Assets and SEC Regulation (Jan. 30, 2020)
[35] OCC, Interpretive Letter 1174 (Jan. 4, 2021).
[36] Bloomberg, Federal Reserve's Digital Dollar Push Worries Wall Street (Mar. 22. 2021).

learning, in the financial services space, and how laws and regulations related to housing, credit, and consumer lending are implicated.[37]

Bank Mergers. Data from the FDIC shows that it approved over 76 mergers between small and mid-sized financial institutions in 2020.[38] Several large mergers were approved by the Fed in 2020, including between Morgan Stanley and E*Trade,[39] and between Charles Schwab and TD Ameritrade.[40] In a February 2021 speech, Governor Michelle Bowman suggested that the Fed may consider an update to its banking antitrust framework;[41] the Department of Justice recently instituted a review of its bank merger review guidelines, drawing criticism and commentary from several scholars.[42]

Durbin Amendment. The Durbin Amendment to Dodd-Frank tasked the Fed with regulating interchange swipe fees charged by banks on debit card transactions. This rule, which was finalized in 2011, prohibiting banks from charging interchange fees above 21 cents plus five basis points on the total transaction cost. On May 7, 2021, the Fed proposed an expansion of this regulation relating to card-not-present transactions.[43]

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.[44] This follows the NCUA Board approving a final interpretive ruling and policy statement allowing people convicted of certain minor offenses to return to work in the credit union industry without applying for the Board's approval.[45]

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[37] Federal Reserve, FDIC, CFPB, NCUA, OCC, Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, Including Machine Learning (Mar. 29, 2021).
[38] FDIC, *Mergers Decisions: Annual Report to Congress,* (Dec. 31, 2020).
[39] Fed, *Federal Reserve announces approval of notice by Morgan Stanley,* (Sep. 30, 2020).
[40] Fed, *Federal Reserve Board announces approval of notice by The Toronto-Dominion Bank,* (Sep. 30, 2020).
41 Governor Michelle Bowman, *My Perspective on Bank Regulation and Supervision,* (Feb. 16, 2021).
42 Federal Trade Commission, *Comment of Commissioner Chopra,* (Oct. 16, 2020).
[43] Fed, *Federal Reserve Board invites public comment on proposed changes to Regulation II regarding network availability for card-not-present debit card transactions and publishes a biennial report containing summary information on debit card transactions in 2019,* (May 7, 2021).
[44] 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).
[45] NCUA, *Board Approves Second-Chance Policy Changes* (Nov. 21, 2019).

Appendix: Legislation

- **H.J. Res. 35, Resolution of Disapproval on the OCC's National Banks and Federal Savings Associations as Lenders Final Rule (C. Garcia).** This bill, which is identical to Senate-passed S. J.Res. 15, would nullify the OCC's problematic final "True Lender" rule on bank partnerships.
- **H.R. ____, Central Liquidity Facility Enhancement Act** would permanently extend enhancements for NCUA's Central Liquidity Facility (CLF) made in the CARES Act.
- **H.R. ____, Countercyclical Capital Buffer Act** would require the Fed to activate the countercyclical capital buffer (CCyB) for the largest banks upon the Federal Open Market Committee (FOMC) increasing interest rates.
- **H.R. ____, Diversity in Financial Regulatory Advisory Committees Act** 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.
- **H.R. ____, Expanding Financial Access for Underserved Communities Act** would, among other things, allow credit unions to expand their field of membership to include underserved communities that lack a depository institution branch within 10 miles.
- **H.R. ____, Expanding Opportunities in Banking Act** would expand employment opportunities at banks and credit unions for certain formerly incarcerated individuals.
- **H.R.____, Federal Reserve Bank Board Diversity Act,** 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. ____, NCUA Oversight of Third Party Vendors Act**, which would reauthorize and make permanent authority the NCUA temporarily had between 1998 and 2002 over credit union third-party vendors from between 1998 and 2002, similar to permanent authority bank regulators have pursuant to the Bank Service Company Act.
- **H.R. ____, Promoting New and Diverse Depository Institutions Act,** which would require the Fed, OCC, FDIC, NCUA, and CFPB, in consultation with the Treasury Secretary, to conduct an 18 month study about challenges prospective de novo depository institutions face, and to develop a strategic plan to promote the creation of newly chartered depository institutions, particularly MDIs and CDFIs, in a manner that promotes, among other things, safety and soundness, consumer protection, and community reinvestment.