STATEMENT OF

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on

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

before the

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for the opportunity to testify today.

Since I last testified before this Committee six months ago, an additional two quarters of financial reporting from depository institutions shows that the banking system continues to be a source of strength for Americans and their financial needs.

Our nation's banks have withstood the initial economic and financial market volatility of 2020, reflecting their strength going into the pandemic – including strong asset quality and robust capital and liquidity positions. After weathering the initial shock, banks became instrumental in supporting individuals and businesses through lending and other financial intermediation and by distributing financial support provided by the federal government. In contrast to the high number of bank failures during the last financial crisis,[1] only three banks failed during the pandemic, and none were due to the pandemic or the ensuing economic stress.

Today, I will provide an update on six areas of focus for the FDIC:

- The state of the banking system and the return to the "new normal;"
- Our continued response to economic risks related to the pandemic;
- Resolution readiness;
- The supervisory process and regulatory actions;
- Financial inclusion; and
- Fostering innovation and American competitiveness.

[1] *See* Chapter 5: Deposit Insurance: Fund Management and Risk-Based Deposit Insurance Assessments, *in* CRISIS AND RESPONSE: AN FDIC HISTORY, 2008–2013, available at https://www.fdic.gov/bank/historical/crisis/.

I. State of the Banking System and the Return to the "New Normal"

A. *State of the Banking System*

Banking sector income for 2020 declined from its 2019 level, primarily due to higher provision expenses resulting from both the implementation of the Current Expected Credit Losses accounting methodology (CECL) by large banks and economic uncertainty associated with the pandemic. Despite this overall decline, fourth quarter net income rose, primarily due to higher noninterest income and lower provision expenses for credit losses, a reflection of both economic improvement and a more optimistic economic outlook. Net interest margin was unchanged from the record low level reached last quarter. Banks also reported modest declines in asset quality and loan volume.[2] The FDIC is in the process of analyzing call report data for the first quarter of 2021 that appears generally consistent with the fourth quarter of 2020. The FDIC is scheduled to release that data on May 26.

Despite the challenges of the pandemic, banks increased their capital levels in 2020. Total bank equity rose by 5.4 percent to $2.2 trillion. At year-end 2020, capital ratios remained strong with average core (or leverage) capital at 8.81 percent, average common equity tier one capital at 13.87 percent, and average total risk-based capital at 15.48 percent.[3]

When I last appeared before the Committee, I reported that the banking system had accommodated a sharp increase in customer demand for deposits that far exceeded any deposit growth the FDIC had seen in the past.[4] Deposit growth accelerated in the fourth quarter, reflecting persistently high savings rates and lower spending.[5] The deposit trend in the first quarter of this year appears generally consistent with last year's deposit growth, due primarily to continued fiscal support for the economy.

Sector consolidation slowed modestly in 2020. The net rate of consolidation for the banking sector in 2020 was 3.4 percent, the lowest rate since 2008. A slower rate of mergers, very few failures, and a low rate of voluntary closures contributed to the overall trend.

Banks of all sizes have continued to support their customers and communities throughout the pandemic, including by continuing to originate the overwhelming majority of approximately $800 billion in Small Business Administration-guaranteed Paycheck Protection Program (PPP) loans.[6] While total loan and lease balances declined for the banking sector in the fourth quarter,

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[2] *See* FDIC, Quarterly Banking Profile, Fourth Quarter 2020, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2020dec/qbp.pdf#page=1.

[3] *See id*. at 5-6.

[4] *See* FDIC, Quarterly Banking Profile, Second Quarter 2020, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2020jun/.

[5] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[6] *See* SBA, Paycheck Protection Program (PPP) Report Approvals through 04/18/2021, available at https://www.sba.gov/sites/default/files/2021-04/PPP_Report_Public_210418-508.pdf.

primarily as a result of PPP loan forgiveness, loans increased over the full year 2020 by approximately 3.3 percent.[7]

The low interest rate environment coupled with economic uncertainties will continue to challenge the banking sector, placing downward pressure on revenue and the net interest margin. However, as noted above, the banking sector maintains strong capital and liquidity levels, which can mitigate potential future losses.

B. *Return to the "New Normal"*

With the rollout of the COVID-19 vaccination program throughout the United States, the reopening of the economy, and the physical return to office for businesses throughout the country, there is guarded optimism that things will return to normal, whatever our "new normal" may look like. Though we continue to be encouraged by the state of the banking sector, uncertainty remains, including in areas that have been directly impacted by the pandemic and the related economic shutdowns. Below are several areas the FDIC is monitoring.

Commercial Real Estate

While commercial real estate (CRE) noncurrent loan levels remain manageable and well below previous crisis levels, there is uncertainty in the recovery of the CRE market given long-term leases and other potential lagging changes. In particular, pandemic-related changes in business travel, shopping, and work-from-home practices could challenge the lodging, retail, and downtown office market if those practices become permanent.[8]

Agricultural Lending

The pandemic initially looked to pose challenges to U.S. farmers. However, government assistance, a rebound in commodity prices in the second half of 2020, and a resurgence in export demand combined to improve agricultural conditions for borrowers and lenders. Furthermore, strong farmland equity has enabled farmers to restructure loans to manage operating losses and replenish working capital. Despite improving agricultural market fundamentals, net farm income is forecast to decrease in 2021 from 2020 levels because of lower direct government farm payments.[9]

Consumer Lending

In light of the pandemic, consumer borrowing declined in 2020 compared to 2019.[10] Business closures, higher levels of unemployment, changed consumer behavior resulting from

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[7] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[8] *See* FDIC, 2021 Risk Review (May 10, 2021), at 26-28, available at https://www.fdic.gov/analysis/risk-review/2021-risk-review/2021-risk-review-full.pdf.

[9] *See id*. at 4; U.S. Department of Agriculture, February 2021 Farm Income Forecast (Feb. 5, 2021), available at https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farm-income-forecast/.

[10] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

the pandemic, and higher income levels resulting from fiscal stimulus all contributed to lower levels of consumer borrowing.[11] Likewise, a number of banks tightened underwriting standards due to repayment concerns and risks of default.[12] At the same time, banks are reporting lower credit card balances and greater repayment of existing balances on those cards.[13] In contrast with the experience of the 2008 financial crisis, mortgage delinquencies in bank portfolios have remained relatively low and the underlying fundamentals of the housing market, such as homeowner equity and housing supply relative to demand, are strong.[14]

Technology Investments

The rapid transformation of the last year has amplified how critical technology is to empowering people's lives amidst a global pandemic. Innovation will continue to play a vital role for banks as they seek to meet consumer expectations for access to financial services and to improve the resilience of their operations. The pandemic has accelerated banks' adoption of digital banking and other new technologies. These advances have the potential to bring more people into the banking system, to provide access to new products and services, and to lower the cost of credit. As the FDIC works to foster these investments, we must also be mindful of the challenges that confront our institutions, particularly community banks that face budget, personnel, and competitive challenges to innovation, as well as growing cybersecurity risks.

Cybersecurity

Banks must also take steps to manage the risk that accompanies new technologies, to protect the sensitive information in their systems, and to ensure resilience in the face of attacks from those that might seek to disrupt bank operations. As the FDIC noted in January 2020, "disruptive and destructive attacks against financial institutions have increased in frequency and severity."[15] The pandemic and the related shift to doing an increasing amount of economic activity online have made increased vigilance in the area of cybersecurity all the more important. Technology can also enhance resilience in the face of security challenges, such as cyberattacks, in addition to operational challenges such as the pandemic.

Climate

The FDIC expects financial institutions to consider and appropriately address potential climate risks that could arise in their operating environment. This includes physical risks

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[11] *See* 2021 Risk Review, *supra* note 8.

[12] *See id*.; Board of Governors of the Federal Reserve System, Senior Loan Officer Opinion Survey on Bank Lending Practices (July and October 2020), available at https://www.federalreserve.gov/data/sloos.htm.

[13] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2; 2021 Risk Review, *supra* note 8.

[14] *See* 2021 Risk Review, *supra* note 8; *see also* CoreLogic, Homeowner Equity Insights Report, Fourth Quarter 2020.

[15] *See* FDIC, FIL-03-2020, Heightened Cybersecurity Risk Considerations (Jan. 16, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20003.html.

associated with extreme weather events, such as hurricanes, floods, storms, tornadoes, droughts, and fires.

We also expect institutions to mitigate the risks associated with adverse climate or weather-related events that are common to specific locations or particular areas of the country. Such activities can include ensuring the institution and its borrowers have appropriate insurance coverage, adjusting borrowers' cash flow estimates based on reduced agricultural yields or adverse business conditions, and complying with applicable rules, regulations, and building codes.

The FDIC will continue to monitor the impact of climate and other emerging risks on the financial sector. FDIC economists and financial analysts conduct internal analysis of a range of factors that affect economic and banking conditions, including the potential implications of changing environmental conditions. Several FDIC Regional Risk Committees include environmental factors in their regular analysis, such as drought in the western states.

The FDIC will continue to engage with other regulatory bodies, domestic and international, on how best to address such risks, and looks forward to contributing to interagency work in this area.

II. The FDIC's Continued Response to the Economic Risks Related to the Pandemic

Beginning in March of last year, the FDIC undertook a broad array of swift actions to maintain stability and public confidence in the nation's financial system. These actions focused on providing necessary flexibility to both banks and their customers – particularly the most heavily affected individuals and businesses – while maintaining the safety and soundness of the banking system. Throughout this period, the FDIC's supervisory activities and other essential functions have continued.

A. *Encouraging Banks to Assist Affected Customers and Communities*

In mid-March of last year, we issued a statement to encourage banks to work with all borrowers, especially borrowers from sectors particularly vulnerable to the existing economic volatility, including airlines; energy companies; travel, tourism, and shipping companies; small businesses; and independent contractors that are reliant on affected industries.[16]

Notably, we made clear that prudent modifications to the terms on existing loans for affected customers of FDIC-supervised banks would not be subject to examiner criticism. We also noted that the FDIC would work with affected financial institutions to reduce burdens when scheduling examinations.

Shortly thereafter, we worked with the Financial Accounting Standards Board (FASB) to confirm that short-term loan modifications (e.g., six months) made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not troubled debt

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[16] *See* FDIC, FIL-17-2020, Regulatory Relief: Working with Customers Affected by the Coronavirus (Mar. 13, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20017.html.

restructurings (TDRs).[17] This clarification was critical to ensuring banks would be able to modify loans to borrowers impacted by the pandemic and lockdowns. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) subsequently expanded TDR relief to a broader set of loan modifications, and this relief was extended for another year in December.

In June, the FDIC and our fellow federal and state banking regulators issued examiner guidance that outlined principles for how examiners would supervise banks in light of the ongoing impact of the pandemic.[18] Notably, the guidance stated that examiners would continue to consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise appropriate flexibility in their supervisory response. We also made clear that actions taken in good faith reliance on statements issued by the agencies would not be subject to criticism or other supervisory action down the road, and we still stand by that.

B. *Providing Flexibility for Banks*

To increase the capacity of banks to meet customer needs, we worked closely with the other federal agencies to make targeted regulatory changes to facilitate lending and other financial intermediation, including as mandated by the CARES Act.

Soon after the onset of the pandemic, we encouraged institutions to use their capital and liquidity buffers to support customers in a safe and sound manner.[19] The FDIC, Federal Reserve, and Office of the Comptroller of the Currency (OCC) issued an interim final rule that gave institutions implementing CECL in 2020 the option to delay for two years an estimate of its effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period.[20]

The FDIC also took a series of other actions to allow institutions to extend funds expeditiously to creditworthy households in light of the strains in connection with COVID-19, often in conjunction with our fellow regulators. For example, we temporarily reduced the

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[17] *See* FDIC, FIL-36-2020, Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus (Apr. 7, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20036.html; FDIC, FIL-22-2020, Inactive: Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus (March 22, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html. This March 22 statement was issued prior to the enactment of the CARES Act and was moved to inactive status following issuance of the Apri17 statement.

[18] *See* FDIC, FIL-64-2020, Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions (June 23, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20064.html.

[19] *See* FDIC, Federal Banking Agencies Provide Banks Additional Flexibility to Support Households and Businesses (Mar. 17, 2020), available at https://www.fdic.gov/news/news/press/2020/pr20030.html.

[20] *See* Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances, 85 Fed. Reg. 17723 (Mar. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-06770.pdf.

community bank leverage ratio to 8 percent,[21] permitted institutions to defer obtaining an appraisal or evaluation for up to 120 days,[22] provided a 45-day grace period for submitting annual audit reports,[23] and – to address the dramatic increases in banking assets caused by the fiscal and monetary responses to the pandemic – allowed community banks to use their end-of-2019 asset size for determining applicability of several regulations through the end of 2021.[24]

Taken together, these actions increased flexibility for these institutions to comply with regulatory obligations as they worked to meet customer needs.

C. *Fostering Small Business Lending*

The FDIC also took a number of steps to facilitate the ability of banks to make loans to small businesses under the PPP. Overall, the PPP highlighted the vital role of banks in supporting small businesses. We saw that among the banks participating in the PPP, community banks in particular had an outsized impact on their customers and communities.[25]

Among other things, the FDIC established an FAQ resource for bankers[26] and issued a Financial Institution Letter for banks with important information on the PPP, including links to the SBA and U.S. Department of Treasury's webpages regarding the program.[27] The FDIC and the other bank regulatory agencies also issued interim final rules that allowed banking organizations to neutralize the regulatory capital effects[28] and the Liquidity Coverage Ratio

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[21] *See* Regulatory Capital Rule: Temporary Changes to the Community Bank Leverage Ratio Framework, 85 Fed. Reg. 22924 (Apr. 23, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-23/pdf/2020-07449.pdf; Regulatory Capital Rule: Transition for the Community Bank Leverage Ratio Framework, 85 Fed. Reg. 22930 (Apr. 23, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-23/pdf/2020-07448.pdf.

[22] *See* Real Estate Appraisals, 85 Fed. Reg. 21312 (Apr. 17, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-17/pdf/2020-08216.pdf.

[23] *See* FDIC, FIL-30-2020, Statement on Part 363 Annual Reports in Response to the Coronavirus (Mar. 27, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20030.html.

[24] *See* Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021: Federal Deposit Insurance, 85 Fed. Reg. 67428 (Oct. 23, 2020), available at https://www.fdic.gov/news/board/2020/2020-10-20-notice-dis-c-fr.pdf; Temporary Asset Thresholds, 85 Fed. Reg. 77345 (Dec. 2, 2020), available at https://www.fdic.gov/news/board/2020/2020-11-17-notational-fr-a.pdf.

[25] *See* FDIC, FDIC Quarterly, Quarterly Banking Profile: Third Quarter 2020, Volume 14, No. 4 (2020), at 31, available at https://www.fdic.gov/bank/analytical/quarterly/2020-vol14-4/fdic-v14n4-3q2020.pdf.

[26] *See* FDIC, Frequently Asked Questions on the Small Business Administration's Paycheck Protection Program (Apr. 5, 2020), available at https://www.fdic.gov/coronavirus/smallbusiness/faq-sb.pdf.

[27] *See* FDIC FIL-33-2020, New SBA and Treasury Programs Available for Small Business Relief (Apr. 2, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20033.html.

[28] *See* Regulatory Capital Rule: Paycheck Protection Program Lending Facility and Paycheck Protection Program Loans, 85 Fed. Reg. 20387 (Apr. 13, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-13/pdf/2020-07712.pdf.

(LCR) effects[29] of participating in the Federal Reserve's PPP lending facility. We later issued a final rule to mitigate the deposit insurance assessment effect of participating in the PPP.[30]

D. *Maintaining the Deposit Insurance Fund*

The Deposit Insurance Fund (DIF) balance was $117.9 billion on December 31, up $1.5 billion from the end of the third quarter and the highest level ever.[31] However, the reserve ratio declined one basis point to 1.29 percent because of strong insured deposit growth, and not as the result of losses to the DIF. In September 2020, the FDIC adopted a Restoration Plan to restore the reserve ratio to at least the statutory minimum of 1.35 percent within eight years, absent extraordinary circumstances, as required by the Federal Deposit Insurance Act.[32] In accordance with the Restoration Plan, FDIC staff continues to monitor closely the factors that affect the reserve ratio.

III. Resolution Readiness

Throughout the pandemic, the FDIC has continued its work on enhancing our resolution readiness, both in the short-term and in the long run. As the FDIC responded to the immediate impact of the pandemic, we established a new approach to closing failed banks to include appointing a health and safety officer, obtaining and using cleaning supplies and protective personal equipment, establishing a smaller on-site closing team supplemented by a remote team, employing greater use of technology, and modifying travel plans for attending the closing.

Our work in 2019 to form a new division – the Division of Complex Institution Supervision and Resolution – centralized our supervision and resolution activities for banks with more than $100 billion in total assets for which the FDIC is not the primary regulator.[33] This centralized approach has greatly improved the FDIC's ability to prepare for resolution of larger banks and enhanced our preparedness in the event of a crisis. Last fall, we added additional experience to the agency's Systemic Resolution Advisory Committee, a committee that brings together expertise inside and outside the agency to discuss the challenges, opportunities, and progress being made to implement our systemic resolution mission.[34]

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[29] *See* Liquidity Coverage Ratio Rule: Treatment of Certain Emergency Facilities, 85 Fed. Reg. 26835 (May 6, 2020), available at https://www.fdic.gov/news/board/2020/2020-04-30-notational-fr.pdf.

[30] *See* Assessments, Mitigating the Deposit Insurance Assessment Effect of Participating in the Paycheck Protection Program (PPP), the PPP Liquidity Facility, and the Money Market Mutual Fund Liquidity Facility, 85 Fed. Reg. 38282 (June 26, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-06-26/pdf/2020-13751.pdf.

[31] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[32] *See* FDIC, FIL-90-2020, Restoration Plan for the FDIC Deposit Insurance Fund (Sept. 15, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20090.html.

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

[34] *See* FDIC, FDIC Advisory Committees: Systemic Resolution Advisory Committee (SRAC), available at: https://www.fdic.gov/about/advisory-committees/systemic-resolutions/index.html.

The FDIC has also worked closely with our international counterparts, including the Bank of England and the Single Resolution Board of the European Union, to monitor and prepare for cross-border resolution of global systemically important banks (GSIBs).[35] The FDIC and Federal Reserve are co-Chairs of the Crisis Management Groups for U.S. GSIBs, where we engage with firms and domestic and foreign authorities to facilitate cross-border resolution planning. We participate in financial regulatory dialogues, such as the U.S.-EU Joint Financial Regulatory Forum[36] and the U.S.-UK Financial Regulatory Working Group,[37] which are avenues for enhanced cooperation on cross-border resolution planning. We also remain active in the work on cross-border resolution cooperation that occurs in international fora, such as the Financial Stability Board, by participating in its Resolution Steering Group, among other contributions.

The FDIC continues to review resolution plans submitted under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, in January of this year, the FDIC announced plans to resume requiring resolution plans for insured depository institutions (IDIs), or IDI plans, for firms with $100 billion or more in assets.[38] The FDIC is working on providing additional details in the coming weeks regarding future implementation of the IDI rule.

IV. Supervisory Process and Regulatory Actions

A. *Supervisory Process*

Maintaining our Supervisory Programs and Examinations

As we responded to the challenges of the pandemic, the FDIC maintained its supervisory programs for both safety and soundness and consumer protection and worked with institutions that were experiencing operational challenges. The majority of institutions have had no difficulty continuing ongoing FDIC supervisory activities, and only a small number have asked for brief delays due to pandemic-related operational challenges or on-site document access limitations.

The FDIC has also conducted heightened monitoring of financial institutions whose activities or concentrations may have made them more vulnerable to the economic consequences of the pandemic. We have expanded our regular risk monitoring activities, particularly for

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[35] *See, e.g.*, FDIC Chairman Jelena McWilliams, "Resolution Readiness: Adapting to our Uncertain World," speech before the Single Resolution Board Annual Conference (Oct. 8, 2020), available at https://www.fdic.gov/news/speeches/spoct0820.html.

[36] *See* U.S. Department of the Treasury, Joint Statement on the U.S.-EU Joint Financial Regulatory Forum (March 29, 2021), available at https://home.treasury.gov/news/press-releases/jy0084.

[37] *See* U.S. Department of the Treasury, Joint Statement on UK-U.S. Financial Regulatory Working Group Meeting (Oct. 22, 2020), available at https://home.treasury.gov/news/press-releases/sm1160.

[38] *See* FDIC, FDIC Announces Lifting IDI Plan Moratorium (Jan. 19, 2021), available at https://www.fdic.gov/resauthority/idi-statement-01-19-2021.pdf; *see also* 12 C.F.R. § 360.10.

institutions that have concentrated exposures to the industries that have been most impacted by the pandemic.

Throughout this period, the FDIC contacted all 50 state banking commissioners, conducted regular meetings with our federal bank regulatory counterparts, spoke to members of Congress, reached out to consumer groups, and maintained regular contact with supervised institutions. These engagements helped us better react to the challenges facing banks and communities across the nation.

Supervisory Engagement Going Forward

As the pandemic struck, the FDIC was forced to move our examination work off-site seemingly overnight, to protect our employees and the staff at banks we supervise. That we were able to transition effectively is a testament to the flexibility of the FDIC workforce and the institutions we supervise. Moreover, it resulted in the growing realization of how much can be accomplished in an examination that takes full advantage of technology.

As the effects of the pandemic fade, we look forward to returning to on-site exams at banks. These interactions help our examiners understand the institutions we supervise, and they provide useful engagement for bankers. But as our institutions evolve, the way we supervise them is evolving as well. Investments in new technology can help reduce the amount of time that examination teams spend on-site at supervised institutions, contributing to quicker examination turnaround and report processing, while strengthening our ability to monitor risk in a more timely manner. The pandemic, and our ability to adjust to it quickly while still fulfilling the agency's mission, have demonstrated that technology can enable us to maintain smaller on-site teams with the remote support of larger off-site teams. This change will reduce travel commitments that have exacted a toll on our examiners and their families, especially those with young children, and thereby can improve retention of examiners.

These advances can also facilitate a more fundamental policy objective: the necessary evolution of our supervision and examination processes from static, point-in-time assessments to more routine engagement and timely analyses that will enhance our ability to monitor, identify, and mitigate risk at individual institution and in the financial system as a whole.

B. *Regulatory Actions*

Brokered Deposits

At the end of 2020, the FDIC Board approved a final rule updating our brokered deposits regulations, the first meaningful update to the brokered deposits regulations since the rules were first put in place approximately 30 years ago. As the banking sector transformed over those decades, the FDIC received many questions regarding whether specific deposit arrangements were brokered or not. The agency typically responded on a one-off basis, resulting in a fragmented legal framework. Meanwhile, many types of deposit arrangements that bear little resemblance to the brokered deposits of the 1980s were categorized as brokered under the regulation.

The new rule is intended to encourage innovation in how banks offer services and products to customers by removing regulatory hurdles to certain types of innovative partnerships between banks and fintechs.[39] The final rule accomplishes this by tailoring the scope of deposits captured to align more closely with the types of deposits Congress intended to capture when the restrictions were first put in place. The rule also creates a more transparent and consistent regulatory approach by providing a clearer description of the criteria for meeting the "facilitation" prong of the deposit broker definition and establishing a consistent process for application of the primary purpose exception.

The final rule became effective on April 1, with an optional extended compliance date of January 1, 2022. The FDIC created a dedicated webpage that contains information relevant to the regulation, including filing instructions for the notice and application process.[40]

Although the new framework represents an important step forward, the brokered deposits statute will continue to present inevitable implementation challenges. In 2019, I suggested that Congress consider replacing Section 29 of the Federal Deposit Insurance Act, the section imposing restrictions on brokered deposits, with a simple restriction on asset growth for troubled institutions.[41] This would be a far simpler regime for the FDIC and industry to administer, and would more directly address the problem Congress was trying to tackle in the original legislation. I continue to believe that a simple restriction on asset growth for troubled institutions would be a superior approach in the long run.

<u>Industrial Banks</u>

In December of last year, we finalized a rule to codify and clarify legally enforceable commitments we generally require insured industrial banks and industrial loan companies (collectively, industrial banks) and their parent companies to enter into as a condition of approval.[42] These commitments include capital and liquidity maintenance agreements (CALMAs), which contractually obligate a parent company to serve as a source of strength for an industrial bank. The rule provides transparency to potential future applicants and the public regarding the FDIC's requirements for parent companies of industrial banks and ensures that all parents of industrial banks approved for deposit insurance going forward are subject to such required commitments.

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[39] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg., 6742 (Jan. 22, 2021), available at https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf.

[40] *See* FDIC, Banker Resource Center: Brokered Deposits, available at https://www.fdic.gov/resources/bankers/brokered-deposits/.

[41] *See* FDIC Chairman Jelena McWilliams, "Brokered Deposits in the Fintech Age," speech before the Brookings Institution (Dec. 11, 2019), available at https://www.fdic.gov/news/news/speeches/spdec1119.html.

[42] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703 (Feb. 23, 2021), available at https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-b-fr.pdf.

Computer-Security Incident Notification

Also at the end of 2020, we issued a proposed rule together with the OCC and Federal Reserve to enhance reporting of computer-security incidents by requiring notification within 36 hours of knowledge of covered incidents.[43] The proposal would enable regulators to understand quickly if regulated banks have been the victim of a serious computer-security incident that may "materially disrupt, degrade, or impair" the bank's operations or threaten the financial stability of the United States. The proposed rule seeks to provide balance – avoiding unnecessarily difficult or time-consuming reporting obligations while permitting regulatory agencies to be in a position to provide assistance to a bank or the broader financial system when significant computer-security incidents occur. We are in the process of considering the comment letters received in response to that proposal and engaging with our fellow regulatory agencies as we move to issue the final rule.

Suspicious Activity Reports

In January 2021, the FDIC issued a notice of proposed rulemaking to permit the agency to grant case-by-case suspicious activity report (SAR) filing exemptions to FDIC-supervised institutions that develop an innovative approach to suspicious activity reporting requirements.[44] The other federal banking agencies issued similar notices. The rule would allow for the issuance of SAR exemptions in lockstep with the Financial Crimes Enforcement Network (FinCEN). The FDIC is also working with FinCEN and the other federal banking agencies to implement the requirements of the Anti-Money Laundering Act (AML Act) and the Corporate Transparency Act (CTA).

Supervisory Appeals

This past January, we finalized a proposal to establish a new Office of Supervisory Appeals to hear appeals by banks of material supervisory determinations made by examiners.[45] Historically, the FDIC's appeals process was rarely used. From the beginning of 2007 through the end of 2020, only about 50 appeals were filed out of more than 110,000 exams.[46] Reviewing officials in the new office, which we are currently in the process of setting up, will be devoted

[43] *See* Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers, 86 Fed. Reg. 2299 (Jan. 12, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-01-12/pdf/2020-28498.pdf.

[44] *See* FDIC, FIL-11-4-2020, Proposed Rulemaking to Permit Additional Exemptions to Suspicious Activity Report Requirements (Dec. 15, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20114.html.

[45] *See* FDIC, FIL 04-2021, Revised Guidelines for Appeals of Material Supervisory Determinations (Jan. 19, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21004.html.

[46] Total appeals includes a number of appeals that were not decided upon because the appeal was withdrawn by the institution, the issues were found not to be appealable, or the institution closed. Total exams includes safety and soundness, trust, information technology, Bank Secrecy Act, consumer protection, and Community Reinvestment Act examinations conducted by FDIC as primary federal supervisor.

solely to hearing appeals, providing time and capacity for the proper attention and diligence. Our new appeals process will help promote consistency among examiners across the country, ensure accountability at the agency, and ultimately, help maintain stability and public confidence in the nation's financial system.

Supervisory Guidance

This past January, we approved a final rule regarding the role of supervisory guidance.[47] The final rule clarifies the differences between regulations and guidance, and makes clear that supervisory guidance does not create binding, enforceable legal obligations. Guidance can play an important role in providing clarity to supervised institutions, but, unlike a law or regulation, guidance is not an appropriate basis on which to take enforcement action. The rule further clarifies that the FDIC will not issue supervisory criticisms for violations of supervisory guidance. We also affirmed that we do not make supervisory recommendations solely on the basis of reputational risk.

V. Financial Inclusion

The health of the banking sector affects our communities in many ways, not least of all in standing ready to provide access to checking or savings accounts and other critical financial services. Creating an inclusive financial system has been one of my priorities as Chairman, and is rooted in my own experiences as an immigrant to this country. Because the FDIC is a bank regulatory agency, we have approached this issue from the perspective of financial services.

A. *How America Banks Report*

The FDIC has seen meaningful improvements in recent years in reaching the "last mile" of unbanked households in this country. Based on the results of our biennial survey of households, the proportion of U.S. households that were banked in 2019 – 94.6 percent – was the highest since the survey began in 2009.[48] Notwithstanding these improvements, we know that much remains to be done. Over 7 million households do not have a banking relationship to deposit their checks or with which to save for unexpected expenses.[49] The rates for Black and Hispanic households who do not have a checking or savings account at a bank remain substantially higher than the overall "unbanked" rate.[50] Similarly, Black and Hispanic households across all income levels are less likely to use forms of bank credit (e.g., a credit card,

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[47] *See* FDIC, FDIC Approves Rule on the Role of Supervisory Guidance (January 19, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21005.html.

[48] *See* How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey, available at https://www.fdic.gov/analysis/household-survey/2019report.pdf.

[49] *See id*. at 1.

[50] *See id*. at 2.

personal loan, or line of credit from a bank).[51] Savings rates remain lower among these households,[52] which results in greater difficulty dealing with unexpected expenses.[53]

To help address these disparities, the FDIC is using its authorities to support a safer, fairer, and more inclusive banking system. We have recently launched a targeted public awareness campaign, #GetBanked, to inform consumers about the benefits of developing a relationship with a bank. Having a basic checking account can be an important first step to becoming part of the financial fabric of this country and we are pleased that an increasing number of banks are offering low-cost and no-fee accounts that work for people with limited means.

B. *Mission-Driven Banks*

As the supervisor of the majority of the nation's community banks, including minority depository institutions (MDIs) and Community Development Financial Institutions (CDFIs), the FDIC also plays an important role in ensuring these institutions can meet the needs of their customers and communities.[54] In November 2020, we announced the establishment of the Mission-Driven Bank Fund that will channel private sector investments to support MDIs and CDFIs, through a variety of asset classes.[55] We have engaged a financial advisor and two law firms to develop the framework, structure, and concept of operations for the fund, but the FDIC will not manage the fund, contribute capital to the fund, or be involved in the fund's investment decisions. Our goal is for anchor investors to hire a fund manager in the second quarter of 2021, conduct a fundraising round, and be prepared for the fund to accept pitches from MDIs and CDFIs in the third quarter.

C. *Diversity, Equity, and Inclusion*

The FDIC recently released a new diversity strategic plan outlining five "C"s – Culture, Career, Communication, Consistency, and Community – designed to help guide us on our

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[51] *See id*. at 8.

[52] *See id*. at 52.

[53] *See* Board of Governors of the Federal Reserve System, Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020 (May 2020), available at https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf.

[54] Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) sets forth several statutory goals for the FDIC and other financial regulators, including: (1) preserve the number of MDIs; (2) preserve the minority character in cases involving merger or acquisition of an MDI; (3) provide technical assistance to prevent insolvency of institutions not now insolvent; (4) promote and encourage creation of new MDIs; and (5) provide for training, technical assistance, and educational programs.

[55] *See* FDIC, FDIC Seeks Financial Advisor to Establish New "Mission-Driven Bank Fund" to Support FDIC-Insured Minority Banks and Community Development Financial Institutions (Nov. 18, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20125.html.

journey to support diversity, equity, and inclusion.[56] The plan contains actionable steps that will guide our work over the next few years and help us measure our progress. We will further integrate diversity, equity, and inclusion into our hiring, training, and career development programs, enhance accountability within the organization, and provide additional support for MDIs. The FDIC has made much progress in these areas over the years, but we know we can do more, and we will.

D. *Support for the Emergency Capital Investment Program*

We have also taken steps to facilitate the timely implementation and acceptance of the Emergency Capital Investment Program (ECIP), which was created by the Department of the Treasury pursuant to the Consolidated Appropriations Act, 2021. The ECIP enables the Treasury to make capital investments in certain low- and moderate-income community financial institutions. The FDIC, together with the OCC and Federal Reserve, issued an interim final rule in March 2021 that will facilitate the implementation of the ECIP by providing certainty that the preferred stock issued under the program qualifies as additional tier 1 capital and that subordinated debt issued under the program qualifies as tier 2 capital under the regulatory capital rule.[57]

VI. Fostering Innovation and American competitiveness

The rapid transformation of our lives in the past year has amplified how critical innovation is to enabling banks and communities to meet the challenges of the pandemic and to ensuring that American banks remain competitive in a rapidly changing world. Early in my tenure at the FDIC, we established a new Office of Innovation – FDiTech – to promote innovation at the agency and across the banking sector,[58] and we hired our first Chief Innovation Officer earlier this year.[59]

A. *Rapid Prototyping*

Last year, we also announced a rapid prototyping competition, a type of tech sprint. For this competition, our challenge was to promote more regular reporting from community banks, where technology levels vary greatly, without increasing reporting burdens or costs. More than 30 technology firms were invited to participate in this competition,[60] and we have reviewed

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[56] *See* FDIC, FDIC Releases Strategic Plan to Reinforce Diversity, Equity, and Inclusion Within the Agency and Among the Financial Institutions It Supervises (Mar. 3, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21016.html.

[57] *See* Regulatory Capital Rule: Emergency Capital Investment Program, 86 Fed. Reg. 15076 (Mar. 22, 2021), available at https://www.fdic.gov/news/board/2021/2021-03-05-notational-fr.pdf.

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

[59] *See* "FDIC Appoints First Chief Innovation Officer" (Feb. 16, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21009.html.

[60] *See* FDIC, FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html.

prototypes from the 11 vendors that made it to phase three of the competition.[61] The technologies demonstrated by these vendors show great promise, and we are reviewing the legal, regulatory, and contractual framework needed to successfully encourage the market to adopt technologies like this. Tools like those developed in this competition will help pave the way for more seamless and timely reporting of more granular data in the future for banks that voluntarily choose to adopt them.

B. *Artificial Intelligence*

In March of this year, alongside our fellow regulators, we issued an interagency request for information (RFI) on financial institutions' use of artificial intelligence (AI).[62] AI can offer a range of benefits for banks, consumers, and businesses, such as expanding credit access through innovative use of data and faster underwriting. As we receive and review comments to the RFI, we will be particularly interested in feedback on how financial institutions use AI, whether AI is helpful to them, and whether additional regulatory clarity would be helpful.

AI and alternative data can be especially important for small businesses, such as sole proprietorships and smaller companies owned by women and minorities. Such businesses often do not have a long credit history, which is why novel measures of creditworthiness, like income streams, can help provide critical access to capital, particularly in difficult times.

C. *Digital Assets*

On May 17, the FDIC issued an RFI seeking comment on banks' current and potential activities related to digital assets. We have been closely following developments in the emerging digital asset ecosystem for some time. Banks have increasingly begun exploring a variety of potential roles, such as being custodians, reserve holders, issuers, and exchange or redemption agents; performing node functions; and holding digital asset issuers' money deposits. The FDIC is issuing the RFI to better understand current and potential use cases involving IDIs and their affiliates.

VII. Conclusion

Although I am cautiously optimistic that the worst of the pandemic is behind us and that the nation can establish a "new normal," we remain vigilant about economic conditions and the uneven impact of the pandemic and its recovery on different populations throughout the United States. As they have throughout this unprecedented time, the FDIC's 5,845 dedicated employees remain committed to the agency's mission and the financial stability of the United States, as well as its role in supporting a financial system that serves all Americans.

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[61] *See* FDIC, FDIC Selects 11 Companies to Compete in Final Phase of Tech Sprint (Jan. 11, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21004.html.

[62] *See* Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, Including Machine Learning, 86 Fed. Reg. 16837 (Mar. 31, 2021), https://www.govinfo.gov/content/pkg/FR-2021-03-31/pdf/2021-06607.pdf.