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

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November 27, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: December 4, 2019, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions?"

The Committee on Financial Services will hold a hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions?" at 10:00 a.m. on Wednesday, December 4, 2019, in room 2128 of the Rayburn House Office Building. This will be a single-panel hearing with the following witnesses:

- **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), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA). 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.[1] The FDIC, OCC,[2] and NCUA do not have such mandatory testimony requirements.[3] This hearing will examine various supervisory and regulatory developments, rulemakings, and other regulatory activities enacted since these agency principals last testified before the Committee on May 16, 2019.[4]

In 2010, Congress passed the Dodd-Frank Act into law to address many of the regulatory failures that contributed to the financial crisis. In addition to implementing Dodd-Frank rules, regulators have implemented the Basel III capital reforms to strengthen the resiliency of the banking system.[5] Since 2017, the Trump Administration has made financial deregulation a top priority, with the Department of the Treasury issuing a series of reports with recommendations for regulatory and legislative reforms.[6] Last year, Congress

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[1] 12 U.S.C. § 247b.

[2] OCC Comptroller Otting was invited to attend the hearing, but he was unavailable. The OCC is expected to provide written testimony.

[3] 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. For the most recent annual reports from the agencies testifying, *see* Federal Reserve: https://www.federalreserve.gov/publications/annual-report.htm, FDIC: https://www.fdic.gov/about/strategic/report/index.html, and NCUA: https://www.ncua.gov/news/annual-reports. *See also* https://www.federalreserve.gov/publications/supervision-and-regulation-report.htm and https://www.federalreserve.gov/publications/financial-stability-report.htm.

[4] Full Committee Hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness and Accountability of Megabanks and Other Depository Institutions," May 16, 2019.

[5] *See* CRS, "Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act" (Jul. 27, 2016) https://www.crs.gov/Reports/R44573.

[6] *See* U.S. Department of The Treasury, "Regulatory Reform," https://home.treasury.gov/policy-issues/top-priorities/regulatory-reform.

passed S. 2155 into law, which included various deregulatory provisions, that regulators have either finalized or are in the process of implementing.[7] This hearing memo will briefly highlight recent supervisory and regulatory developments, as well as background on diversity in the banking sector.

Recent Supervisory and Regulatory Developments

Community Reinvestment Act. On August 28, 2018, the OCC issued an Advanced Notice of Proposed Rulemaking (ANPR) related to modernizing the Community Reinvestment Act (CRA),[8] receiving nearly 1,500 comments.[9] While the Federal Reserve and FDIC have worked with the OCC to review the ANPR comments, stakeholders have expressed strong concerns that the substance of the ANPR could weaken key aspects of CRA regulations, and that the agencies may not issue a joint rulemaking, creating the potential for regulatory arbitrage.[10] Recent comments from FDIC Chairman McWilliams have indicated the FDIC may join the OCC on issuing a proposal as early as December, without the support of the Federal Reserve.[11]

Enhanced Prudential Standards. In October 2019, the Federal Reserve finalized a rule to create a tiered and tailored enhanced prudential standards (EPS) framework for banks of various sizes, including foreign banking organizations. Additionally, in May 2019, the Federal Reserve and FDIC issued a final rule which created a tiered system of resolution planning (referred to as "living wills") easing what generally was a full plan submission requirement every two years to a modified two-year cycle for U.S. G-SIBs and a three-year cycle for large regional and foreign banks. These large banks are now required to provide a targeted plan in one submission cycle and a full plan in the following cycle, meaning complete living wills will be updated once every four years for U.S. G-SIBs and once every six years for other large banks.[12] Furthermore, earlier this year, the Federal Reserve made revisions to the stress-testing regime to, among other things, limit the use of the "qualitative objection,"[13] which may make it easier for large banks to pass their stress tests.[14]

Community Bank and Credit Union Capital Requirements. Under the Community Bank Leverage Ratio (CBLR) framework, small banks with less than $10 billion in assets that meet certain criteria have the option to meet a CBLR requirement, rather than the existing risk-weighted requirements. Section 201 of S.2155 granted federal banking agencies authority in setting the exact CBLR ratio, as the provision mandated a range between 8% and 10%. In October 2019, bank regulators finalized a rule with a 9% threshold, effective January 1, 2020.[15] Furthermore, in October 2018, NCUA amended its 2015 risk-based capital rule to delay the effective date until January 1, 2020, and raise the asset threshold from $100 million to $500 million in assets.[16] In June 2019, the NCUA again delayed the effective date to January 1, 2022.[17]

Volcker Rule. In May and June of 2018, the prudential regulators, along with the Securities and Exchange Commission (SEC) and Commodity Future Trading Commission (CFTC), issued a joint proposal to significantly modify the Volcker Rule.[18] In July 2019, regulators finalized a joint rule exempting smaller banks with less than $10 billion in assets, with trading assets and liabilities less than 5% of total assets. In

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[7] *See* CRS, "Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) and Selected Policy Issues" Jun. 6, 2018, and Americans for Financial Reform, "The Senate's Dangerous Financial Deregulation Bill (S 2155)."
[8] *See* OCC, Advance Notice of Proposed Rulemaking for Community Reinvestment Act, Aug. 28, 2018
[9] *See* OCC, Public Submissions to Reforming the Community Reinvestment Act Regulatory Framework.
[10] *See* FSC, "The Community Reinvestment Act: Assessing the Law's Impact on Discrimination and Redlining," Apr. 9, 2019.
[11] Victoria Guida, "FDIC's McWilliams says she'll probably sign on to CRA proposal next week," *Politico*, Nov. 20, 2019. Also see Andrew Ackerman, "Rewrite of Lower-Income Lending Rules to Advance in December," Wall Street Journal, Nov. 14, 2019.
[12] While the largest foreign banks were placed on the described three-year cycle, other foreign banks will be required to submit reduced resolution plans. *See* Federal Reserve, FDIC, "Resolution Plans Required," 84 *Federal Register* 93, May 14, 2019, p. 21600, and Federal Reserve, Resolution Plan Visuals.
[13] *See* Federal Reserve, "Federal Reserve Board announces it will limit the use of the "qualitative objection" in its CCAR 2019 cycle," Mar. 6, 2019.
[14] Alan Rappeport and Emily Flitter, "Regulators Move to Ease Post-Crisis Oversight of Wall Street," New York Times, Mar. 6, 2019.
[15] Fed, OCC, FDIC, " Regulatory Agencies Issue Final Rule to Simplify Capital Calculation for Community Banks," Oct. 29, 2019.
[16] *See* NCUA, "Risk-Based Capital Rule to Become Effective in 2020; Asset Threshold Raised," Oct. 2018.
[17] See NCUA, "Delay of Effective Date of the Risk-Based Capital Rules," 84 *Federal Register* 30048-30050, June 26, 2019.
[18] *See* "Federal Reserve Board asks for comment to simplify and tailor compliance requirements relating to the "Volcker rule"", May 30, 2018

October 2019, the regulatory agencies finalized revisions that included differences from the earlier proposal. The regulators assert the revision generally does not change what activities are allowed or not allowed, and that the rule in its new form will provide greater clarity and certainty.[19] However, critics have characterized the final revision as being too deferential to banks' concerns with the original proposal.[20] The rule states that additional Volcker Rule reforms will be addressed in a future rulemaking.

Swap Margin Proposal. In October 2019, federal banking regulators issued a proposed rule modifying the swap margin rule to "facilitate the implementation of prudent risk management strategies."[21] The proposed rule would exempt uncleared swaps with inter-affiliates from initial margin requirements, while keeping variation margin requirements. In a dissenting statement on the proposal, Federal Reserve Governor Lael Brainard argued that a swap margin exemption for inter-affiliates poses prudential risk to banks until broader rules on relationships with, and restrictions on, affiliates are updated within Sections 23A and 23B of the Federal Reserve Act, respectively.[22]

Bank Mergers and Acquisitions. Concerns have been raised about federal financial regulators rubber stamping prior merger and acquisition applications. For example, based on data provided by the Federal Reserve, from January 1, 2006 through December 31, 2017, over 3,800 merger applications were submitted to the agency. During this eleven-year period, however, the Federal Reserve did not reject *any* merger application.[23] On November 20, the Federal Reserve and FDIC granted approval of the merger between BB&T and SunTrust, creating the sixth-largest bank in the United States.[24]

Industrial Loan Companies. Industrial Loan Companies (ILCs) are federally insured state-chartered banks not subject to the Bank Holding Company Act (BHCA), including federal consolidated supervision or limitations on non-banking activities that most other banks are subject to.[25] In recent years, three fintech firms and a Japanese online retailer have applied for FDIC insurance to establish an ILC.[26] Two of the fintech firms withdrew their applications, and another fintech firm withdrew then resubmitted its application and is currently pending regulatory approval, along with the Japanese online retailer's application. These applications have renewed debates about the effectiveness of the current ILC regulatory framework, and concerns about maintaining the historic separation of banking and commerce.[27]

Real-Time Payments. In August 2019, the Federal Reserve announced plans to create an interbank real-time payments (RTP) system by 2023 or 2024. The Fed stated that the new system will be available to all banks with a reserve account, and it will require banks using this new system to make those funds available to their customers immediately after being notified of settlement. According to Fed Chair Powell, "the United States is far behind other countries in terms of having real-time payments available to the general public."[28]

Oversight of Technology Service Providers. Considering financial firms' growing reliance on technology service providers (TSPs), concerns have been raised related to the appropriate financial regulatory framework applicable to these TSPs. For example, in July 2019, Capital One announced that a cybersecurity breach

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[19] Federal Reserve, OCC, FDIC, SEC, and CFTC, joint statement, "Agencies Finalize Changes to Simplify Volcker Rule," press release, Oct. 8, 2019.
[20] For example, see Pete Schroeder, "U.S. regulators hand Wall Street a major win with stripped-down 'Volcker Rule'," Reuters, Aug. 20, 2019.
[21] OCC et al., "Agencies Propose Rule to Amend Swap Margin Rules," press release, October 28, 2019, at. See also FDIC, "Fact Sheet," Sep. 17, 2019.
[22] Federal Reserve, "Statement by Governor Lael Brainard," press release, Oct. 28, 2019. Also see a dissenting statement by FDIC Board Member Martin Gruenberg and a 2015 letter from Americans for Financial Reform to the CFTC outlining their views on the importance of maintaining swap margin requirements on inter-affiliate transactions.
[23] *See* Letter from Chairman Powell to Senator Warren regarding bank mergers and acquisitions, May 10, 2018.
[24] *See* American Banker, "Fed, FDIC sign off on BB&T-SunTrust megamerger — with a catch," Nov. 19, 2019.
[25] ICBA, "Industrial Loan Companies: Closing the Loophole to Avert Consumer and Systemic Harm," March 2019.
[26] Jon Prior, "Latest to Seek ILC Charter Is Japanese E-commerce Firm," July 26, 2019.
[27] *See* Federal Reserve, OCC, FDIC Section 620 Report, Sep. 2016; and ABA-BPI Joint Comment Letter Opposing Rakuten ILC Application, Aug. 30, 2019.
[28] Federal Reserve, "Transcript of Chair Powell's Press Conference," July 31, 2019.

occurred, which involved the bank's use of Amazon Web Services, exposing the personal information of 106 million consumers.[29] Unlike the banking regulators, the NCUA lacks to supervise TSPs.[30]

Ex-Offenders with Minor Offenses Seeking Employment. In November 2019, the FDIC issued a proposal seeking public comment to codify its Statement of Policy 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 offenses[31] In addition, the NCUA Board approved 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.[32]

Derisking. Concerns have been raised that Anti-Money Laundering/Bank Secrecy Act requirements may unintentionally discourage banks from providing financial services, like correspondent banking, to certain regions like the Caribbean region, and that policymakers should consider solutions.[33]

Increased Appraisal Requirement Thresholds. In July 2019, the NCUA increased its appraisal threshold requirements for non-residential transactions to $1 million from $250,000. In November 2019, NCUA issued a proposed rule, exempting appraisal requirements for residential transactions valued under $400,000.[34] The proposed rule follows a September 2019 announcement where federal banking agencies adopted a final rule increasing the residential threshold amount from $250,000 to $400,000.[35]

Applicability of State Usury Caps. In November 2019, the FDIC and OCC issued a proposed rulemaking to clarify that when a loan that is non-usurious when originated by a bank, it remains non-usurious if the loan is sold, assigned, or otherwise transferred to a non-bank. In 2015, the Second Circuit held in *Madden v. Midland Funding*, that non-bank debt collectors that had purchased debt originated by a national bank could not benefit from the bank's exportation power.[36] The OCC stated the proposal is intended to "address confusion resulting from" the *Madden* decision.[37] Stakeholders have raised concerns that the proposal will encourage predatory rent-a-bank schemes that are designed to evade state usury caps.[38]

Payday Alternative Loans. In October, the NCUA broadened its Payday Alternative Loans (PALs) framework to allow credit unions to offer additional short-term, small dollar products.[39] A new PALs II loan may have an amount up to $2000 and have fully amortizing payments over a term of one to 12 months. Furthermore, there is no minimum membership length requirement to be eligible for a PALs II. The maximum interest rate for a PALs II loan is 28 percent, though NCUA Board Member Todd Harper raised concerns in his dissent that the new program could result in triple-digit effective annual percentage rates.[40]

Brokered Deposits. The FDIC considers brokered deposits less stable, because third-party brokers are more willing to withdraw these deposits and move them to another bank offering higher rates. However, it is not always clear if a particular deposit arrangement qualifies as a brokered deposit and should be restricted. The

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[29] Nicole Hong, Liz Hoffman, and Anna Maria Andriotis, "Capital One Reports Data Breach Affecting 100 Million Customers, Applicants," *The Wall Street Journal*, July 30, 2019.
[30] See NCUA, "NCUA Board Member Todd. M. Harper Statement During the Cybersecurity Board Briefing" (Oct.2019).
[31] *See* "FDIC Proposes New Rule Codifying Policy on Section 19 Hiring," Nov. 19, 2019.
[32] NCUA, "Board Approves Second-Chance Policy Changes," Nov. 21, 2019.
[33] Scott MacDonald, "Is There a 'New Normal' for De-risking in the Caribbean?" Oct. 16, 2019
[34] *See* NCUA, "Board Approves Second-Chance Policy Changes," Nov.21, 2019
[35] *See* Fed, "Agencies issue final rule to exempt residential real estate transactions of $400,000 or less from appraisal requirements," Sept 27, 2019
[36] 786 F.3d 246, 249-53 (2d Cir. 2015)
[37] https://www.occ.treas.gov/news-issuances/news-releases/2019/nr-occ-2019-132.html
[38] For example, see NCLC, "FDIC/OCC Proposal Would Encourage Rent-a-Bank High-Cost Predatory Lending," Nov. 18, 2019.
[39] *See* NCUA, "Payday Alternative Loans," 84 *Federal Register* 51942-51952, October 1, 2019.
[40] *See* NCUA, "NCUA Board Member Todd M. Harper Statement on the Payday Alternative Loans II Final Rule," Sep. 2018

FDIC has initiated a review of the regulations related to brokered deposits and interest rate restrictions, and made a request for public comment in February 2019.[41]

Accounting Standards. Credit loss reserves help mitigate the overstatement of income on loans and other assets by adjusting for potential future losses on related loans and other assets. The last financial crisis revealed the current accounting method realized credit losses too late in the economic cycle, therefore the Financial Accounting Standards Board (FASB) promulgated a new credit loss standard, called Current Expected Credit Loss (CECL), which requires estimated credit losses to be reserved at the time a loan is made [42] The largest banks must begin to comply in 2020 while credit unions and most other banks will need to comply beginning in 2023.[43] In October, prudential regulators proposed a policy statement that is intended to promote consistency in the interpretation and application of the CECL standard.[44]

Diversity in Banking

Based on feedback from the nation's largest bank to an inquiry led by Reps. Waters and Beatty, the Committee found that while the U.S. population is over 50% women and 40% minorities:

- The boards of directors of the largest banks are comprised of only 29% women and 17% minorities;
- There is no U.S. global significantly important bank (G-SIB) with a female or minority CEO at the helm;
- Chief diversity officers do not report directly to the CEO at any G-SIB;
- Only 4 out of 8 megabanks spent more than $1 billion on diverse suppliers in 2018; and
- While $1.4 billion is the average spent by U.S. G-SIBs on supplier diversity, less than 1% of megabank spending is devoted to diverse asset managers and suppliers, and only 4% of externally managed assets go to diverse-owned firms.[45]

Legislative Proposals

- Reregulating Megabanks Act. This legislation would codify the April 2014 regulation that U.S. G-SIBs maintain a 6% enhanced supplementary leverage ratio (eSLR), and their holding companies maintain a 5% eSLR.[46] The bill would ensure leverage requirements are included in stress testing and would require analysis regarding G-SIB capital requirements, including the Countercyclical Capital Buffer (CCyB).
- Financial Institution Living Will Improvement Act. The bill would require banks submit resolution plans, known as "living wills," every two years. A similar bill passed the House by a 414-0 vote in 2018.[47]
- Proprietary Trading Disclosures Act. The bill would require the FDIC, in consultation with other regulators, to annually report on the Volcker Rule's implementation and large bank trading activities.
- Close the ILC Loophole Act. (C. Garcia). The discussion draft would eliminate an exemption to the Bank Holding Company Act that permits ILCs and their corporate owners to operate outside of that law's regulatory framework, including consolidated supervision and activity restrictions, unlike other banks.
- Mergers and Acquisition Disclosure of Diversity and Inclusion Act (Cleaver). The bill would require banks subject to a merger or acquisition to include diversity and inclusion data with their application.
- Federal Reserve Bank Board Diversity. The bill would require persons selecting regional Federal Reserve Bank boards of directors to consider at least one individual reflective of gender and racial diversity.
- Promoting Diversity and Inclusion in Banking Act. The bill would require bank examinations of diversity and inclusion efforts, including policies to promote diversity and inclusion, and it would require responses to Office of Women and Minority Inclusion (OMWI) assessments of diversity policies and practices.

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[41] 12 C.F.R. §1867(c). FDIC, "Brokered Deposits and Interest Rate Restrictions," 84 Federal Register 2366-2372, February 6, 2019, and 12 C.F.R. §337.6(a).

[42] Financial Account Stability Board (FSAB), "About the FASB." While the SEC technically has the authority to set the accounting standards in the United States, it has traditionally deferred to FASB to set the standards. Also see CRS, "Banking: Current Expected Credit Loss (CECL)," Oct. 9, 2018.

[43] American Banker, "FASB extends CECL deadline for most lenders," July 17, 2019.

[44] Fed, OCC, FDIC, National Credit Union Administration (NCUA), "Interagency Policy Statement on," 84 Federal Register 55510-55513, Oct. 17, 2019.

[45] FSC Press Release, "Committee Finds More Work is Needed to Improve Diversity at Megabanks," Aug. 13, 2019

[46] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140408a.htm

[47] https://www.congress.gov/bill/115th-congress/house-bill/4292