STATEMENT OF

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on

OVERSIGHT OF FINANCIAL REGULATORS

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
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Chairman Crapo, Ranking Member Brown, and members of the Committee, thank you for the opportunity to testify today before the Senate Committee on Banking, Housing, and Urban Affairs.

When I testified before this Committee six months ago, we were confronting great uncertainty and volatility due to the COVID-19 pandemic. Many industries and segments of the economy were experiencing unprecedented declines in activity, and this shock was reverberating throughout the financial system.

Although there remains considerable uncertainty about the path of the economy, we know from two quarters of industry-wide reporting that the banking system has served as a source of strength throughout this period. Notwithstanding declines in aggregate earnings, during the first half of the year banks of all sizes supported their customers and communities, including by originating the vast majority of over $500 billion in Small Business Administration-guaranteed Paycheck Protection Program (PPP) loans.[1]

The banking system's ability to support the economy reflects the industry's strong capital and liquidity positions. In the second quarter of 2020, aggregate equity capital increased to more than $2.1 trillion, which translated to an average common equity tier 1 capital ratio of 13.4 percent.[2] On both an aggregate and percentage basis, these capital levels were slightly higher than the quarter immediately preceding the pandemic.

In addition, the banking system has accommodated two consecutive quarters of over $1 trillion in new deposits, customer demand that far exceeds any deposit growth the FDIC has seen in the past.[3] These inflows demonstrate public confidence in the banking system, as individuals and businesses sought safety during the uncertain economic environment.[4]

To support the ability of banks to work constructively with their customers, the Federal Deposit Insurance Corporation (FDIC) has taken meaningful actions to provide banks necessary flexibility while maintaining safety and soundness.

Today, I will provide an update on five areas in which we have made significant progress:

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[1] *See* SBA, Paycheck Protection Program (PPP) Report, available at https://www.sba.gov/sites/default/files/2020-08/PPP_Report%20-%202020-08-10-508.pdf.

[2] *See* FDIC, Quarterly Banking Profile, Second Quarter 2020, available at https://www.fdic.gov/bank/analytical/qbp/2020jun/qbp.pdf.

[3] *See id.* at 4.

[4] This growth has been so rapid and substantial that, despite a $1.4 billion increase in the Deposit Insurance Fund (DIF) during the second quarter of 2020 – resulting in a record balance of $114.7 billion – the DIF reserve ratio fell from 1.39 percent in the first quarter to 1.30 percent, which is below the required minimum level of 1.35 percent. This reduction was solely a result of the unprecedented increase in bank deposits, and we believe deposit growth is likely to normalize in the upcoming quarters and that the reserve ratio will rise above 1.35 percent without any need to modify assessment rates in the near-term. *See* Federal Deposit Insurance Corporation Restoration Plan, 85 Fed. Reg. 59306 (Sept. 21, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-09-21/pdf/2020-20690.pdf ("...it is the FDIC's view that raising assessments based on two quarters of extraordinary insured deposit growth would be premature.").

- Responding to economic risks related to COVID-19;
- Enhancing resolution readiness;
- Supporting communities in need;
- Fostering technology solutions and encouraging innovation; and
- Finalizing outstanding rulemakings.

I appreciate the opportunity to update the Committee on each of these key issues.

I. Responding to Economic Risks Related to COVID-19

Beginning in early March, the FDIC and our fellow regulators undertook a series of actions that helped maintain stability in financial markets. Specifically, we (1) encouraged banks to use their capital and liquidity buffers to lend and provide other critical financial services, (2) made targeted, temporary regulatory changes to facilitate lending and other financial intermediation, (3) provided needed flexibility for banks to work with their borrowers and modify loans when appropriate, and (4) fostered small business lending by facilitating the use of new government programs, including the PPP.[5]

Regulation

Over the past six months, the FDIC has taken additional regulatory actions in support of these objectives. For example, we issued a final rule to mitigate the deposit insurance assessment effect of participating in the PPP and the PPP lending facility, as well as the Money Market Mutual Fund Liquidity Facility.[6]

In addition, the FDIC, Federal Reserve Board (FRB), and the Office of the Comptroller of the Currency (OCC) issued an interim final rule providing insured depository institutions (IDIs) subject to the supplementary leverage ratio (SLR) the ability to elect to temporarily exclude deposits at Federal Reserve Banks and U.S. Treasuries from total leverage exposure.[7] Absent these adjustments, the increase in IDIs' balance sheets may cause a sudden and significant spike in regulatory capital needed to meet the SLR requirements. This adjustment, which will remain in effect through March 31, 2021 for banks that make the election, will support the ability of IDIs to accommodate customer deposit inflows and serve as financial intermediaries in the U.S. Treasury market without incentivizing banks to take on additional risk.

Last month, we issued an interim final rule that would allow IDIs that have experienced growth to determine whether they are subject to the requirements of Part 363 of the FDIC's regulations (*i.e.*, Annual Independent Audits and Reporting Requirements) for fiscal years

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[5] For a more detailed description of these actions, see FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (May 12, 2020), available at https://www.fdic.gov/news/speeches/spmay1220.html.

[6] *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.

[7] *See* Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio for Depositor Institutions, 85 Fed. Reg. 32980 (June 1, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-06-01/pdf/2020-10962.pdf.

ending in 2021 based on their consolidated assets as of December 31, 2019.[8] Such IDIs, whose asset growth may be temporary but significant, would otherwise be required to develop processes and systems to comply with these requirements on a potentially short-term basis. The FDIC is also actively considering similar targeted adjustments to further mitigate unintended consequences resulting from pandemic-related government programs.

Supervision

Along with targeted regulatory changes, we have also taken supervisory actions intended to increase flexibility for banks to meet customer needs. In March, we encouraged banks to work with all borrowers, especially those from industry sectors particularly vulnerable to economic volatility, and we clarified that prudent efforts to modify the terms on existing loans for affected customers will not be subject to examiner criticism.[9]

In June, the FDIC, FRB, OCC, and National Credit Union Administration – in conjunction with the state banking regulators – issued examiner guidance to outline the supervisory principles for assessing the safety and soundness of institutions given the ongoing impact of the pandemic.[10] Notably, the guidance states that examiners will consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise appropriate flexibility in their supervisory response.

In addition, we provided additional information regarding loan modifications, including by confirming with the staff of the Financial Accounting Standards Board that short-term 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 restructurings (TDRs) under ASC Subtopic 310-40.[11] In conjunction with the other members of the Federal Financial Institutions Examination Council (FFIEC), we issued further guidance on additional loan accommodations related to COVID-19, which discusses loan modifications and TDRs in greater detail. We continue to monitor conditions and receive feedback from supervised institutions, and we will consider additional guidance as appropriate.

PPP

Before I conclude my remarks on the FDIC's response to the COVID-19 pandemic, I would like to offer a few high-level observations regarding the PPP. This program highlighted

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[8] *See* The FDIC Approves Interim Final Rule to Provide Temporary Relief from Part 363 Audit and Reporting Requirements (Oct. 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20114.html.
[9] *See* FDIC, FIL-17-2020, *Regulatory Relief: Working with Customers Affected by the Coronavirus* (Mar. 13, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20017.html.
[10] *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.
[11] *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; *see also* FDIC-FIL-22-2020, *Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus* (Mar. 22, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html.

the vital role of community banks in supporting small businesses through commercial and industrial (C&I) lending. We know that the overwhelming majority of community banks focus their C&I lending on small businesses and often have key advantages in flexibility and the speed with which they can deliver funding.[12]

These attributes, as well as strong ties to their borrowers and communities, likely explain why community banks have played an outsized role in the PPP. As of the second quarter of 2020, community banks held approximately $148 billion, or 31 percent of all PPP loans – a significant share relative to the 15 percent of total industry loans and 13 percent of total C&I loans. Overall, all banks held approximately $482 billion in PPP loans, or 92 percent of total PPP loans made.

To further highlight their important role during the pandemic, community banks experienced a growth rate of 13.5 percent for total loans and 63 percent for C&I loans in the second quarter of 2020. These rates contrast with the broader banking industry, which experienced a growth rate of 0.6 percent for total loans and 5.9 percent for C&I loans during the same period. With respect to PPP lending, we can certainly see that community banks have had an outsized impact on their customers and communities. The FDIC took a number of steps to provide information to banks and facilitate their ability to make loans to small business under the program.

II. Enhancing Resolution Readiness

As the FDIC responded to the immediate impact of the COVID-19 pandemic through these targeted regulatory and supervisory actions, we also focused on enhancing our resolution readiness in several ways.

Although we entered the pandemic with a historically low number of bank failures – the four failures in 2019 were the first since December 2017 – we recognized that the absence of failures could not last forever.[13] Accordingly, even before the onset of the pandemic, the FDIC has taken steps to improve our resolution-related capabilities.[14]

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[12] *See* FDIC, 2018 Small Business Lending Survey, available at https://www.fdic.gov/bank/historical/sbls/full-survey.pdf.

[13] *See, e.g.*, FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (Dec. 5, 2019), available at https://www.fdic.gov/news/news/speeches/spdec0519.html ("This expansion and consequent absence of failures cannot endure forever. It is normal – and indeed expected – for some banks to fail, and our job at the FDIC is to protect depositors and ensure that banks can fail in an orderly manner.").

[14] On March 5, 2020, the FDIC announced that it will offer voluntary retirement and early separation opportunities to approximately 20 percent of its employees to help reshape the agency's workforce for the future and to enhance preparedness. As of July 31, 2019, 42 percent of the FDIC's workforce is eligible to retire within the next five years, which could deplete the FDIC's institutional experience and knowledge, especially during a crisis. This plan was intended to address that risk. Due to the COVID-19 pandemic, however, we put this plan on hold.

Preparedness and Coordination

Our ability to fulfill our mission depends on having an experienced, knowledgeable, and agile workforce. Notwithstanding recent changes that have increased workforce preparedness, we are committed to continuous improvement.

Last year, we announced the centralization of our supervision and resolution activities for banks with more than $100 billion in total assets for which the FDIC is not the primary regulator.[15] This move is more than just an organizational realignment. Rather, combining these key functions has created a stronger, more coherent approach for bank resolution and supervision by enabling us to take a more holistic approach. Following this change, we have experienced organizational synergies that enable us to more efficiently pull together market-based, institution-based, and resolution-based perspectives. This alignment has helped to ensure that information, resources, and expertise are shared in advance and readily available in the event of a crisis.

In response to economic risks related to COVID-19, the FDIC established a new approach to bank closing activities 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. The FDIC has successfully executed three resolutions using these techniques at institutions that failed since March due to enduring financial challenges unrelated to COVID-19.[16] Lessons learned from these resolutions are being incorporated into plans for any future supervisory or resolution activities that may be required on-site at financial institutions during the pandemic.

On March 16, 2020, the FDIC instituted mandatory telework and moved all supervisory activities offsite to protect the health and safety of employees and to provide flexibility to institutions responding to operational challenges brought on by the pandemic. Working with its financial institutions, the FDIC has maintained its supervisory programs for both safety and soundness and consumer protection and is on track to meet all associated statutory requirements and internal goals.[17] The majority of institutions have not had difficulty with the FDIC continuing supervisory activities, and only a small number have asked for brief delays due to pandemic-related operational challenges at the institution or on-site document access limitations.

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[15] *See* 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.

[16] *See, e.g.*, MVB Bank, Inc. of Fairmont, West Virginia, Acquires The First State Bank, Barboursville, West Virginia (Apr. 3, 2020), available at https://www.fdic.gov/news/news/press/2020/pr20046.html.

[17] *See* section 10(d) of the Federal Deposit Insurance Act (12 U.S.C. 1820(d)) as implemented by section 337.12 of the FDIC's Rules and Regulations. Since March 16 (and through November 1), the FDIC has started and finalized 829 safety and soundness examinations, 843 Bank Secrecy Act examinations, 819 information technology examinations, 174 trust examinations, 4 registered transfer agent examinations, 520 examinations for consumer compliance along with an evaluation of performance under the Community Reinvestment Act, 139 examinations for consumer compliance only, and an additional 4 evaluations of performance under the Community Reinvestment Act alone.

The FDIC has conducted heightened monitoring of financial institutions whose activities or concentrations may present additional concerns due to the economic consequences of the pandemic. We have expanded our regular risk monitoring activities, particularly for institutions that have concentrated exposures to the industries that have been most impacted by the pandemic. Various division across the FDIC coordinate to bring together institution-specific and macroeconomic information, including assessments of aggregate banking industry vulnerabilities to credit and liquidity risk.

The FDIC also continues its coordination with our international counterparts – including those in the European Union, United Kingdom, and Switzerland – on cross-border resolution for global systemically important banks (GSIBs).[18] These longstanding relationships allowed us to maximize coordination during the onset of economic and financial market volatility related to the pandemic. We will continue to build plans, test scenarios, and improve capabilities in order to enhance our collective resolution readiness.

To further develop our perspectives on issues related to the resolution of systemically important financial institutions, the FDIC recently hosted a meeting of our Systemic Resolution Advisory Committee (SRAC) to discuss and receive updates on resolution planning under bankruptcy and resolution planning under the Orderly Liquidation Authority.[19] The FDIC will continue to foster dialogue on emerging resolution-related issues through this platform.

Targeted Engagement

In addition to the resolution plans submitted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the FDIC has a rule requiring resolution plans for certain IDIs with more than $50 billion in total assets. In November 2018, we announced that the FDIC would revise this rule and that the next round of IDI plans would not be required until this rulemaking process has been completed.[20] In April 2019, the FDIC issued an advance notice of proposed rulemaking (ANPR) seeking comment on potential changes to the agency's approach to IDI plans.[21] The FDIC has reviewed the comment letters on the ANPR and intends to issue a proposed rule on IDI plans.

Resolution planning remains critical for the FDIC and large banks. Although the FDIC is not requiring IDI plans during the pendency of the rulemaking process, we have begun carrying out targeted engagement and capabilities testing with select firms on an as-needed basis. This

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[18] *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.

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.

[20] *See* FDIC Chairman Jelena McWilliams, "Keynote Remarks," speech before the 2018 Annual Conference of The Clearing House (TCH) and Bank Policy Institute (BPI) (Nov. 28, 2018), available at https://www.fdic.gov/news/speeches/spnov2818.html.

[21] *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 84 Fed. Reg. 16620 (Apr. 22, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-04-22/pdf/2019-08077.pdf.

approach is consistent with both the requirements of the FDIC's existing IDI plan rule[22] and the approach envisioned under the ANPR, which shifts emphasis toward engagement and capabilities testing.

Rulemaking

Earlier this year, the FDIC finalized two rules that will improve our resolution-related activities. Last month, we finalized a rule to reduce interconnectedness within the financial system and limit the potential for financial sector contagion in the event of the failure of a GSIB.[23] The rule generally requires advanced approaches banking organizations to deduct from regulatory capital the amount of any investment in, or exposure to, total loss-absorbing capacity (TLAC) or long-term debt (LTD) issued by a GSIB that was not already subject to deduction. The single point of entry resolution strategy for resolving U.S. GSIBs relies on investors that hold TLAC and LTD to absorb losses at the point of resolution. By limiting the exposure of large institutions to TLAC and LTD, this rule helps reduce contagion and works with other reforms that enhance the FDIC's ability to resolve a U.S. GSIB.

Earlier this year, we issued a Dodd-Frank Act-mandated final rule, in conjunction with the Securities and Exchange Commission (SEC), to clarify and implement provisions of the statute relating to the orderly liquidation of certain brokers or dealers in the event the FDIC is appointed receiver.[24] Among other things, the rule clarifies how the relevant provisions of the Securities Investor Protection Act of 1970 would be incorporated into a Title II resolution proceeding. Although the FDIC and SEC have acknowledged the limited circumstances in which the rule would be applied, the clarifications provided by the final rule will prove valuable should a broker-dealer be subject to a Title II orderly liquidation.

III. Supporting Communities in Need

As the COVID-19 pandemic continues to disrupt the daily lives of all Americans, we are particularly mindful that minority and low- and moderate-income (LMI) communities have suffered disproportionately, from both a health and economic perspectives. As the nation's deposit insurer and primary supervisor of community banks, including minority depository institutions (MDIs), the FDIC plays an important role in helping these institutions meet the needs of their customers and communities.[25]

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[22] *See* 12 CFR § 360.10(d).
[23] *See* Agencies Finalize Rule to Reduce the Impact of Large Bank Failures (Oct. 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20115.html.
[24] *See* Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 85 Fed. Reg. 53645 (Aug. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-08-31/pdf/2020-16468.pdf.
[25] Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 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.

A significant part of my focus as FDIC Chairman has been bridging the gap between those that belong and those that do not. The need to create a financial system of inclusion and belonging is not theoretical or merely academic to me; it is personal.

We know that individuals from LMI communities are often the least likely to have the very banking and financial services they need most.[26] With respect to minority communities in particular, despite meaningful improvements in recent years, 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. Similarly, Black and Hispanic households are less likely to have mainstream credit (*i.e.*, credit products that are likely reported to credit bureaus) across all income levels.[27] And savings rates remain lower among these households,[28] which results in greater difficulty dealing with unexpected expenses.[29]

These disparities pose challenges to regulators and other policymakers about how best to address them. While we recognize there is no single solution, I would like to discuss the FDIC's initiatives to promote and preserve MDIs.

Preserving and Promoting MDIs

Shaped by my personal experiences and guided by a commitment to increasing financial inclusion in traditionally underserved communities, one of my priorities as FDIC Chairman has been expanding our engagement and collaboration in support of MDIs. An MDI is often the financial lifeblood of the community it serves, enabling individuals and minority-owned small businesses to securely build savings and obtain credit.[30] Although the number of MDIs is comparatively small relative to the total number of FDIC-insured institutions, these banks have a substantial impact on their communities, including through mortgage lending and small business lending.

We have embraced our statutory responsibility to promote and preserve the health of MDIs by seeking new and innovative ways to engage with these institutions and better understand their needs. The FDIC frequently engages with MDIs in Washington and throughout our six regions with technical assistance, banker roundtables, and networking events to connect MDIs and non-MDIs for potential business partnerships.

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[26] *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. In 2019, 5.4 percent of U.S. households were "unbanked," meaning that no one in the household had a checking or savings account. By comparison, 13.8 percent of Black households were unbanked and 12.2 percent of Hispanic households were unbanked.
[27] *See id.* at 10. While 19.7 percent of U.S. households in 2017 had no mainstream credit in the past 12 months, 36 percent of Black households and 31.5 percent of Hispanic households had no mainstream credit.
[28] *See id.* at 44.
[29] *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.
[30] *See, e.g.*, James Barth, Aron Betru, Matthew Brigida, and Christopher Lee, *Minority-Owned Depository Institutions: A Market Overview*, Milken Institute (July 2018), available at https://milkeninstitute.org/sites/default/files/reports-pdf/MDIs-A-Market-Overview.2018.FINAL.pdf.

Last year, the FDIC published a comprehensive research study analyzing the demographics, structural change, geography, financial performance, and social impact of MDIs over a 17-year period ending December 31, 2018.[31] Although the study found improvements in MDIs' financial performance, it also observed that many MDIs face greater economic challenges than non-MDI community banks.

To address some of these challenges, the FDIC has:

- Tripled MDI representation on our Community Bank Advisory Committee (CBAC);[32]
- Established a new MDI subcommittee on the CBAC to highlight the work of MDIs in their communities and to provide a platform for MDIs to exchange best practices;[33]
- Enabled MDIs to review potential purchases of a failing MDI before non-MDI institutions are given this opportunity;
- Clarified that non-MDIs can receive Community Reinvestment Act credit for their collaboration with MDIs;
- Facilitated commitments to support MDIs, including most notably a $100 million commitment by Microsoft;[34] and
- Published a resource guide to promote private and philanthropic investment partnerships with MDIs and Community Development Financial Institutions (CDFIs).[35]

Notwithstanding these important steps, we recognize that we can do more, and "more" in this case will require us to think outside the box.

One of the options we are exploring to support MDIs and CDFIs is a framework that would match these banks with investors interested in the particular challenges and opportunities facing those institutions and their communities. Although we are still developing the details, we are in the process of creating a vehicle through which investors' funds would be channeled to make investments in or with MDIs and CDFIs, including direct equity, structured transactions, funding commitments to loan participations, or potential loss-share arrangements.

This initiative seeks to accomplish several objectives, including maximizing the benefits to MDIs and the communities they serve by providing capital preservation and growth, as well as providing a minimal return to investors.[36] We expect to release more information in the near future.

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[31] *See* FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

[32] *See* FDIC Advisory Committee on Community Banking, available at https://www.fdic.gov/communitybanking.

[33] *See* MDI Subcommittee to FDIC's Advisory Committee on Community Banking, available at https://www.fdic.gov/regulations/resources/minority/subcommittee/index.html

[34] *See* Microsoft, "Addressing racial injustice" (June 23, 2020), available at https://blogs.microsoft.com/blog/2020/06/23/addressing-racial-injustice/.

[35] *See* FDIC, *Investing in the Future of Mission-Driven Banks*, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/guide.pdf.

[36] *See* FDIC, Investing in Banks That Support Communities in Need, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/infographic.pdf; *see also* FDIC, Minority Depository Institutions Program, Investing in the Future of Mission-Driven Banks, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/index.html.

Diversity and Inclusion at the FDIC

The FDIC is deeply committed to fostering a diverse workforce and inclusive work environment. Although we are not yet satisfied with our progress or the pace of change, we have taken meaningful steps in furtherance of this goal.

The racial, ethnic, and gender diversity of the FDIC workforce continues to steadily increase. At the end of 2019, minorities represented over 30 percent of the permanent workforce and women accounted for approximately 45 percent.[37] The FDIC has also increased diversity across our leadership: minorities hold 22 percent of the management-level positions at the FDIC, and women hold 39 percent (up from almost 16 percent and 30 percent, respectively, ten years ago).[38] Likewise, my senior leadership team comprises a diverse set of individuals (38 percent women and 29 percent minorities).[39] Notwithstanding this progress to close longstanding gaps, we know more needs to be done, and we are fully committed to doing it.[40]

In addition to increasing the diversity of our workforce, we also promote the participation of minority- and women-owned businesses (MWOBs) in contracting actions.[41] In 2019, the FDIC awarded 152 contracts, or 29 percent of all contracts, to MWOBs with a total value of approximately $174 million, or 31 percent of all new awards. For any contract over $100,000, review by the Office of Minority and Women Inclusion (OMWI) is required to identify competitive MWOBs to include in contract solicitations. The FDIC has taken a number of actions in 2020 to improve the ability of MWOBs to compete for contracts.

The Legal Division's contracting program endeavors to maximize the participation of both minority- and women-owned law firms (MWOLFs) and minority and women partners and associates employed at majority-owned firms (Diverse Attorneys) in legal contracting. In 2019, the FDIC paid nearly $11 million to MWOLFs and Diverse Attorneys combined, out of a total of approximately $32 million (34 percent) paid to outside counsel. The FDIC made 62 referrals to outside counsel in 2019, of which 20 (32 percent) were to MWOLFs.

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[37] *See* FDIC, Office of Minority and Women Inclusion, *Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress* (2019), available at https://www.fdic.gov/about/diversity/pdf/rtc32620.pdf.

[38] As of September 30, 2020.

[39] As of September 30, 2020.

[40] For a more detailed description of our work in this area, see Nikita Pearson, Acting Director, Office of Women and Minority Inclusion, Federal Deposit Insurance Corporation, "Holding Financial Regulators Accountable for Diversity and Inclusion: Perspectives from The Offices of Minority and Women Inclusion," testimony before H. Comm. on Fin. Servs. (Sept. 8, 2020), available at https://www.fdic.gov/news/speeches/spsep0820.html.

[41] Section 342(c)(2) of the Dodd-Frank Act provides that "[t]he procedures established by each agency for review and evaluation of contract proposals and for hiring service providers shall include, to the extent consistent with applicable law, a component that gives consideration to the diversity of the applicant. Such procedure shall include a written statement, in a form and with such content as the Director shall prescribe, that a contractor shall ensure, to the maximum extent possible, the fair inclusion of women and minorities in the workforce of the contractor and, as applicable, subcontractors."

IV. Fostering Technology Solutions and Encouraging Innovation

As we consider additional ways to create a more inclusive banking system, we must recognize the tremendous benefits that financial innovation can deliver to consumers, including in the areas of payments and credit. New technologies have the potential to bring more people into the banking system, provide access to new products and services, and lower the cost of credit.

For example, last month we released our latest biennial survey on household use of banking and financial services, which shows that individuals have been increasingly moving to digital banking.[42] Specifically, mobile banking and online banking are now the primary methods used to access bank accounts for more than 56 percent of banked households, while use of bank tellers is the primary method for only 21 percent of banked households. Because the survey was conducted in June 2019, it does not reflect changes in consumer behavior associated with the COVID-19 pandemic.

As these trends continue, regulators should aim to foster the development of new technologies that improve the way banks operate by working to remove unnecessary barriers that create operational and regulatory uncertainty for institutions that want to innovate, but are reluctant to do so.[43]

For some community banks, including MDIs, the path to innovation can be challenging. The cost to innovate is often prohibitively high. They may lack the expertise, information technology infrastructure, or research and development budgets to independently develop and deploy their own technology.

To help overcome these challenges, we established an office of innovation – FDiTech – in 2019, and began working on several initiatives to promote innovation and support financial inclusion.

Alternative Data

To help facilitate greater access to credit using new technologies, the FDIC and our fellow regulators issued a statement encouraging the responsible use of alternative data in credit underwriting.[44] Alternative data is information not typically found in the consumer's credit files of the nationwide consumer reporting agencies or customarily provided as part of applications for credit. Using alternative data can improve the speed and accuracy of credit decisions and help firms evaluate the creditworthiness of consumers who might not otherwise have access to credit in the mainstream credit system.

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[42] *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.

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

[44] *See* Federal Regulators issue joint statement on the use of alternative data in credit underwriting (Dec. 3, 2019), available at https://www.fdic.gov/news/news/press/2019/pr19117.html.

Small-Dollar Lending

Similarly, we worked with our fellow regulators earlier this year to issue principles encouraging financial institutions to offer responsible small-dollar loans to customers for both consumer and small business purposes.[45] Even before the COVID-19 pandemic and economic shutdowns throughout the country caused many consumers to lose their jobs, we recognized the important role that such loans can play in helping customers meet their ongoing needs for credit due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national emergencies, or disasters.

Small-dollar credit products and the use of alternative data in underwriting can create a powerful combination for LMI consumers. Our new guidance documents can help encourage FDIC-supervised institutions to offer products to existing and potential customers, consistent with safe and sound banking principles and consumer protection laws.

Partnerships

We are also working on numerous initiatives to facilitate partnerships between fintechs and banks. These partnerships are particularly important to financial inclusion, allowing banks to partner with fintechs that have already developed innovative products and underwriting methods that banks can quickly and safely adopt to support their customers.

To help encourage these partnerships, the FDIC issued earlier this year a guide for fintechs and other third parties looking to work with banks.[46] Using the guide, fintechs that may be new to bank partnerships can gain a better understanding of applicable risk management principles and the due diligence processes banks generally follow to meet them.

More recently, we asked stakeholders to comment on a groundbreaking approach to facilitate technology partnerships. Our request for information proposed a public/private standard-setting partnership and voluntary certification program that would help reduce the cost and uncertainty associated with the introduction of new technology at an institution.[47]

Risk management is an important component of third-party partnerships with banks. But the on-boarding and due diligence process can be costly and time consuming for both banks and their potential technology vendors. These challenges are often amplified at community banks with tight budgets and limited technology expertise. The costs are also high for technology firms. Each bank often has a somewhat different approach to due diligence, and the paperwork and review requirements for vendors are multiplied at each new institution.

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[45] *See* Federal Agencies Share Principles for Offering Responsible Small-Dollar Loans (May 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20061.html.

[46] *See* FDIC, *Conducting Business with Banks: A Guide For Fintechs And Third Parties* (February 2020), available at https://www.fdic.gov/fditech/guide.pdf.

[47] *See* Request for Information on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services, 85 Fed. Reg. 44890 (July 24, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-24/pdf/2020-16058.pdf.

The voluntary certification program we have proposed would create a standard setting organization to establish standards for due diligence of vendors and for the technologies they develop. The FDIC would participate with industry and other stakeholders in the development of these standards. Third-party providers, including fintechs, could then voluntarily submit their organization and technologies to an independent certifying organization to verify conformance to the applicable standards. In turn, banks could rely on this certification to on-board the vendor and integrate the technology into bank operations. Banks would continue to be responsible for exercising appropriate oversight over these vendors, and the products and services offered would still need to comply with all applicable laws, including consumer protection and anti-discrimination.

Standardizing the due diligence process and removing regulatory and operational uncertainty surrounding technologies could fundamentally change the way banks partner with technology firms. We received numerous comments on the proposal, and are reviewing them as we consider next steps.

Financial Reporting

In addition, we recently announced the start of a rapid prototyping competition to help develop a new and innovative approach to financial reporting.[48] Specifically, we invited over 30 technology firms to develop tools for providing more timely and granular data to the FDIC on the health of the banking industry while also making such reporting less burdensome for banks. Last month, we selected 15 of these firms to compete in the next phrase of the competition, in which they will demonstrate their initial prototypes within 70 days and, if selected to continue, a fully functional prototype in 180 days.[49]

Targeted data sets from community banks, more frequently available and more granular than current reporting, could reduce the need for cumbersome quarterly reporting. Such a modernized and automated data system would also improve the ability of supervisors to identify bank-specific and system-wide risks sooner and more efficiently, while simultaneously reducing the compliance burden on individual institutions who voluntarily adopt the technology.

These are only a few of the actions we are taking to facilitate the introduction of innovative technology into the banking industry. We expect them to make banks more efficient and to help introduce new products and services to the market that are safe, affordable, and accessible.

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[48] *See* FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html. Several firms were added as competitors between the initial announcement and the time the final concept papers were due.
[49] *See* FDIC Selects 14 Companies in Tech Sprint to Modernize Bank Financial Reporting (Oct. 15, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20109.html. One additional firm completed contract negotiations a few weeks after this release.

V. Finalizing Outstanding Rulemakings

Although the FDIC does not currently have many open rulemakings, we continue to focus our efforts on modernizing and improving the efficiency and resiliency of the financial system. With respect to rulemakings for which the FDIC has sole jurisdiction, we have prioritized those that are necessary or appropriate at this time and that will not disrupt or add unnecessary uncertainty to the market during time of great volatility. With these principles in mind, the FDIC recently finalized two rules and intends to finalize two others in the near future.

Federal Interest Rate Authority

Earlier this year, the FDIC issued a final rule to clarify the law governing the interest rates state banks may charge.[50] The rule codifies longstanding FDIC guidance to address marketplace uncertainty regarding the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a nonbank. In 2015, the United States Court of Appeals for the Second Circuit issued a decision that called into question such enforceability by holding that 12 U.S.C. § 85 – which authorizes national banks to charge interest at the rate permitted by the law of the state in which the bank is located, regardless of other states' interest rate restrictions – does not apply following assignment of a loan to a nonbank.[51] Although this decision concerned a loan made by a national bank, the Federal Deposit Insurance (FDI) Act provision governing state banks' authority with respect to interest rates is patterned after and interpreted in the same manner.[52]

The final rule addresses this uncertainty and accomplishes three important safeguards for the stability of our financial system by promoting safety and soundness, solidifying the functioning of a robust secondary market, and enabling the FDIC to fulfill its statutory mandate to minimize risk to the DIF.

Section 19

Section 19 of the FDI Act prohibits, without the prior written consent of the FDIC, any person who has been convicted of certain types of crimes, or who has entered into a pretrial diversion or similar program for such crimes, from working at a bank.

Earlier this year, the FDIC issued a final rule that codifies our Statement of Policy (SOP) related to Section 19 and makes several significant changes to the SOP.[53] The changes narrow the scope of crimes subject to Section 19, enabling more individuals to work for banks without going through the Section 19 application process, without increasing risk to the DIF. Among other things, the final rule (1) excludes *all* offenses that have been expunged or sealed – rather than only certain types of expungements – from the scope of Section 19, (2) allows a person with

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[50] *See* Federal Interest Rate Authority, 85 Fed. Reg. 44146 (July 22, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-22/pdf/2020-14114.pdf.
[51] *See* Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015), cert. denied, 136 S. Ct. 2505 (2016).
[52] 12 U.S.C. §1831d.
[53] *See* Incorporation of Existing Statement of Policy Regarding Requests for Participation in the Affairs of an Insured Depository Institution by Convicted Individuals, 85 Fed. Reg. 51312 (Aug. 20, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-08-20/pdf/2020-16464.pdf.

two, rather than one, minor *de minimis* crimes on a criminal record to qualify for the *de minimis* exception, and (3) eliminates the five-year waiting period following a first *de minimis* conviction and establishes a three-year waiting period following a second *de minimis* conviction (or 18 months for individuals whose misconduct occurred when they were 21 or younger).

Brokered Deposits and Interest Rate Caps

Last year, we began a comprehensive review of our longstanding regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized. Since the statutory brokered deposit and rate restrictions applicable to less than well capitalized banks were put in place in 1989 (and amended in 1991), the financial services industry has seen significant changes in technology, business models, and products. In February, we issued an ANPR[54] to seek public comment on all aspects of these regulations.

After considering feedback from the ANPR, we issued a proposed rule that would amend the methodology for calculating the national rate and national rate cap for specific deposit products.[55] Subsequently, we issued a proposed rule that would modernize our brokered deposit regulations.[56] These rulemakings are designed to establish a framework that encourages innovation and provides greater clarity and consistency. We have considered substantial public feedback on the proposals and intend to issue a final rule before the end of the year.

Industrial Loan Companies (ILCs)

ILCs and industrial banks (collectively, "ILCs") are state-chartered, FDIC-supervised financial institutions that can be owned by financial or commercial firms.[57] Congress authorized federal deposit insurance for ILCs in 1982,[58] and exempted ILCs from the definition of "bank" under the Bank Holding Company Act in 1987.[59] These institutions are subject to the same statutory standards as other IDIs for which the FDIC is the primary supervisor. An approved ILC is also subject to the same FDIC safety and soundness, Community Reinvestment Act, and consumer protection requirements as other banks. Earlier this year, we issued a proposed rule that would codify legally enforceable commitments the FDIC generally requires ILCs and their parent companies to enter into as a condition of approval.[60] We intend to finalize this rule in the near future.

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[54] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.

[55] *See* Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized, 84 Fed. Reg. 46470 (Sep. 4, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-09-04/pdf/2019-18360.pdf.

[56] *See* Unsafe and Unsound Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf.

[57] *See* FDIC Supervisory Insights, *Supervision of Industrial Loan Companies* (Summer 2004), available at https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/sisum04.pdf.

[58] *See* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982).

[59] *See* Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552 (Aug. 10, 1987).

[60] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 85 Fed. Reg. 17771 (Mar. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-06153.pdf.

In addition to these FDIC-only rulemakings, we have engaged with our fellow regulators on a number of interagency rulemakings.

Volcker Rule

The Volcker Rule has been one of the most challenging post-crisis reforms for regulators and institutions to implement.[61] The rule generally prohibits large banking entities from engaging in proprietary trading and limits their ability to sponsor or own hedge funds or private equity funds. While the intent of the statute is straightforward, the proprietary trading restrictions were inefficient and the "covered fund" provisions were overly restrictive.

After the five agencies responsible for the Volcker Rule finalized changes to improve the efficiency of the proprietary trading restrictions last year,[62] earlier this year, the agencies finalized changes to revise the restrictions on fund investments in a way that addresses over-breadth while remaining faithful to the statute.[63] We undertook this process out of recognition that, as originally written and implemented, the regulations placed restrictions on several investment funds that the Volcker Rule was never intended to cover. To facilitate capital formation, the rule enables banking entities to provide credit through fund investments that could increase the availability of capital for businesses across the country.

Initial Margin

The mandatory exchange of initial and variation margin for non-cleared swaps is a critical regulatory requirement that reduces the ability of firms to take on excessive risks through swaps without sufficient financial resources. After issuing regulations to implement these requirements five years ago,[64] the FDIC and our fellow regulators made several targeted changes to the framework, including a modification to the requirement that an IDI collect initial margin from affiliates.[65]

Recognizing that banking organizations use inter-affiliate swaps for internal risk management purposes, the rule does not require an IDI to collect initial margin from affiliates until the aggregate amount of such initial margin exceeds 15 percent of the IDI's tier 1 capital. This rule protects the DIF by preventing banking organizations from transferring significant levels of risk to IDIs while also facilitating prudent risk management through inter-affiliate swaps. Importantly, under the rule, all non-cleared swaps – including those with affiliates –

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[61] There have been over 30 interagency issuances to implement the Volcker Rule, including proposals, final rules, and 21 FAQs. *See, e.g.*, FDIC, The Volcker Rule: Frequently Asked Questions, available at https://www.fdic.gov/regulations/reform/volcker/faq/Volcker_Website_FAQs.pdf.

[62] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 61974 (Nov. 14, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-14/pdf/2019-22695.pdf.

[63] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 46422 (July 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-31/pdf/2020-15525.pdf.

[64] *See* Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015), available at https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf.

[65] *See* Margin and Capital Requirements for Covered Swap Entities, 85 Fed. Reg. 39754 (July 1, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-14097.pdf.

remain subject to variation margin, which is calculated and transferred on a daily basis based on the value of the contract.

Net Stable Funding Ratio (NSFR)

Strong liquidity requirements for the largest, most systemically important banks are a key pillar of the post-crisis regulatory framework. In 2014, the FDIC, FRB, and OCC finalized the Liquidity Coverage Ratio (LCR), the first quantitative liquidity standard for U.S. banks.[66] The LCR requires the largest banks to maintain high-quality liquid assets (HQLA) of at least 100 percent of total net cash outflows over a 30-day period.

Last month, we issued a final rule to implement the Net Stable Funding Ratio (NSFR), which complements the LCR by establishing a long-term quantitative liquidity metric. The NSFR will require covered banks to maintain stable funding to support their assets, commitments, and derivatives exposures over a one-year time horizon. Consistent with the tailoring rule,[67] the NSFR will apply based on a bank's size, risk profile, and systemic footprint.

VI. Conclusion

As the FDIC makes progress on these important objectives, we will continue to fulfill our critical mission of maintaining stability and public confidence in the nation's financial system.

Thank you again for the opportunity to testify today, and I look forward to answering your questions.

[66] *See* Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61440 (Oct. 10, 2014), available at https://www.govinfo.gov/content/pkg/FR-2014-10-10/pdf/2014-22520.pdf.
[67] *See* Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.