Oversight of Financial Regulators: A Strong Banking and Credit Union System for Main Street

Senate Committee on Banking, Housing, and Urban Affairs

November 15, 2022

**Opening Statements**

**Chairman Brown (D-OH)** remarked that most Americans want the same thing, an affordable place to live and a stable job, and said that the economy works best when we have a free and fair democracy that works for everyone. He referred to legislation that has lowered prescription drug costs and said that we are tackling inflation by taking on corporate power and reducing our dependence on foreign oil and emphasized the creation of new jobs in America. Brown saw results saying that our economic recovery has been strong and that American families are saving money and seeing wage gains. He said that too many big corporations have taken advantage of market concentration and inflation and said that these corporations are not passing on benefits to consumers. Brown referred to exorbitant bank fees and crypto scams and said that no one wants a scenario where risky bets on Wall Street crash our economy again which is why we have banking and credit union watchdogs. He emphasized the independence of these regulators and said that these regulators continue to work for Main Street. Brown thanked the regulators for working on the CRA, looking at NSF/overdraft fees, addressing mergers and acquisitions, ensuring the safety and soundness of regional banks, and overseeing the formation of new institutions in communities that are often left behind. He said that we must stay vigilant against threats and risks, including those from climate, cyber criminals, and cryptocurrency. Brown said that big tech companies and risky shadow banks should not be allowed to play by different rules. He said that when workers have more power in the economy, it helps the whole economy and helps Americans save money. Brown thanked the witnesses and congratulated Gruenberg on his recent nomination and looked forward to holding a nomination hearing in the coming weeks.

[**Ranking Member Toomey (R-PA**](https://www.banking.senate.gov/newsroom/minority/toomey-financial-regulators-must-not-stray-beyond-mandates-into-politically-contentious-issues)**)** discussed the politicization of federal financial regulators and pointed to global warming. He pointed to the Fed's climate scenario analysis pilot and thought that banks are fully capable of pricing risks into their models and said that the real risk is political. Toomey said that some bank regulators are committed to steering capital away from fossil fuel companies and referred to regulators joining the Network for the Greening of the Financial System (NGFS), which is an international group of financial regulators with a stated aim to “mobilize mainstream finance to support the transition toward a sustainable economy.” He supported Barr’s nomination based on his commitment to stick to the Fed’s narrow mandate and thought the Fed should not be involved in the politically contentious issue of global warming. Toomey pointed to the regulators’ work on resolvability and went on that the Fed and OCC have been approving regional banks for decades and said that as regulation increases, institutions will move out of the banking system. He turned to crypto and stablecoins saying that the regulators have not provided any clarity despite many collapses in the crypto market and referred to the recent FTX events. Toomey said that the ambiguity in the crypto space is a failure of Congress and regulators and it has pushed these businesses overseas. He turned to the deteriorating liquidity in the Treasury market and said that the Fed still has not acted on this after 18-months. Toomey was worried that the Fed would restart bond purchases which would be contrary to their current mission of getting inflation under control.

**Witness Testimony**

[**The Honorable Michael S. Barr**](https://www.federalreserve.gov/newsevents/testimony/barr20221115a.htm)**, *Vice Chair for Supervision*, *Board of Governors of the Federal Reserve System,*** explained that his priority is making the banking system safer and fairer and that his testimony would offer an overview of the banking system’s current conditions and highlight efforts to monitor and mitigate vulnerabilities. First, he noted that capital and liquidity positions remain above regulatory requirements, but we must ensure we are keeping pace and pointed to recent events in the crypto markets as risks to investors. He then moved on to how the Fed is considering improvements to the regulatory capital framework and outlined the principles he would be guided by. Barr discussed the ANPR on enhancing regulators’ ability to resolve large banks in an orderly way as well as the regulators’ review of the merger process. He turned to the need to monitor risks related to crypto activity and how this activity requires effective oversight that includes safeguards to ensure that crypto companies are subject to similar regulatory safeguards as other financial services providers. Lastly, Barr discussed their work on climate-related financial risk with their pilot on climate scenario analysis and operational resilience.

[**The Honorable Todd M. Harper**](https://www.banking.senate.gov/download/harper-testimony-11-15-22)**, *Chair, National Credit Union Administration,*** began by outlining the core goals in the NCUA’s five-year plan and then went on to discuss the state of and factors impacting the credit union system. He noted that while COVID and rising interest rates have impacted credit union performance, credit unions, the Share Insurance Fund, and the Central Liquidity Facility (CLF) have all remained on solid footing. Harper then discussed the NCUA’s efforts to strengthen capital standards, improve the examination process, enhance cybersecurity, protect consumers, preserve Minority Depository Institutions (MDIs), and advance diversity, equity, and inclusion (DEI). He moved on to the recent rulemakings and guidance from the NCUA on multiple issues, including member expulsion, cyber incident notification, use of distributed ledger technologies, and more. Harper then outlined the two legislative requests from the NCUA on permanently adjusting the CLF agent-member requirements to allow agent members to purchase capital stock for a subset of credit unions served as well as the restoration of statutory examination and enforcement authority over third-party vendors.

[**The Honorable Martin J. Gruenberg**](https://www.banking.senate.gov/download/gruenberg-11-15-22)**, *Acting Chair, Federal Deposit Insurance Corporation,*** noted that his oral testimony would focus on the state of the banking industry and the outlook for the industry. He said that the industry has produced positive results this year and it remains well-capitalized and highly liquid. Gruenberg remarked that 14 new banks have opened as of October 2022 and no banks failed during the pandemic. He went on to say that rising market rates and strong loan growth supported an increase in the banking net interest income. However, Gruenberg said that rising interest rates and longer asset maturities also resulted in unrealized losses on investment securities held by banks and said that as of the second quarter of 2022, banks reported $470 billion in unrealized losses and the FDIC expected this trend to be an ongoing challenge. In summary, he said that, despite favorable performance metrics, the banking industry continues to face significant downside risks on multiple fronts that need to be watched in the coming quarters. Gruenberg noted that his written testimony provides an overview of the condition of the banking industry and the FDIC’s Deposit Insurance Fund (DIF). He then updated the Committee on five key policy priorities for 2022: strengthening the Community Reinvestment Act (CRA); addressing the financial risks that are likely to affect banking organizations and the financial system as a result of climate change; reviewing the bank merger process; evaluating the risks of crypto assets to the banking system; and finalizing the Basel III capital rules. He also discussed the FDIC’s efforts to support MDIs and Community Development Financial Institutions (CDFIs). Finally, Gruenberg described the FDIC’s work to strengthen cybersecurity and information security within the banking industry and their recent return to in-person bank examinations and other in-person activities at every level of the FDIC.

[**Mr. Michael J. Hsu**](https://www.banking.senate.gov/download/hsu-testimony-11-15-22)**, *Acting Comptroller, Office of the Comptroller of the Currency,*** emphasized the mission of the OCC and noted the four priorities that he outlined for his agency last year, including (1) guarding against complacency by banks, (2) reducing inequality in banking, (3) adapting to digitalization, and (4) managing climate-related financial risks. He was pleased with the progress of the agency and provided an update on each area. Hsu mentioned overdraft fees saying that the OCC has encouraged banks to reform overdraft and NSF fees. He referred to the updates for analyzing mergers under the Bank Merger Act that the OCC is working on with the Fed and DOJ. He stated that the OCC is focused on safety and soundness of the banking system and referred to the announcement on the creation of an office to monitor bank-fintech relationships. Hsu turned to crypto, saying that the OCC has adopted a careful and cautious approach. He turned to climate related issues and said that it is not the OCC’s role to pick winners and losers, their focus is on risk management.

**Member Questions**

**Chairman Brown (D-OH)** said that this year we have seen crypto markets crash and crypto exchanges implode, resulting in investors losing their money and workers losing their jobs. He said that private cryptocurrencies are not backed by the government and should not be. Brown said that since he has been Chair, many Democrats have raised warning flags on crypto and he thanked the panel for their skepticism on crypto. He believed that there are many other risks to the financial system that need to be focused on beyond crypto and asked the panel to discuss the biggest risks that each of their agencies see. Harper responded that he saw four risks: interest rate risk, liquidity risk, cybersecurity risk, and credit risk, which particularly happens as unemployment rises. Gruenberg thought that we are at an inflection point in our economy with a rising interest rate environment and thought institutions would have to pay close attention to the interest rate risk on their balance sheets, both through longer term assets and the unrealized losses on securities. He thought that asset exposures in commercial real estate and mortgage markets are risks as well. Hsu thought that the greatest risk is the risk of complacency and said that banks are not paying sufficient attention to this as we deal with other risks like crypto. He mentioned some tail risks, such as geopolitical, commodities, and non-bank financials, need to be paid attention to as well. Barr echoed the Fed’s attention to the management of liquidity risk and how cybersecurity is also an issue to be watchful for. He added that the Fed is worried about financial institutions considering the risk in commercial real estate and residential housing. Barr said that the Fed is paying attention to longer term risks as well, mentioning climate, the war in Ukraine, and potential risks in China. Lastly, he was concerned about risks that we do not know about in the nonbank sector where the Fed does not have transparency.

**Ranking Member Toomey (R-PA)** followed up on Brown’s comments on crypto that insinuated that crypto products may crash our financial system. Toomey clarified that this is not about the kind of assets held by FTX, but about what the individuals did with those assets. He noted that the 2008 crisis was caused by what people were doing with mortgages and we did not ban mortgages. He continued by saying that FTX egregiously failed to treat customer assets as segregated assets and understood that the OCC discourages banks from providing custody services in the crypto space. Toomey thought that if there were custody services from a wide range of institutions, it would provide better reassurance to people and asked if this was true. Hsu replied that the OCC discourages banks from doing anything that is not safe, sound, and fair, and said that the custody of crypto is different and that there are questions regarding the custody of crypto that have not been fully worked out. Toomey asked why there is no clarity or guidance on this. Hsu replied that if banks can demonstrate that they can do this in a safe and sound way, the OCC is all ears. Toomey thought that the OCC should still provide clarity on how this works and turned to Barr on his comments on types of crypto-related activity where the Fed needs to provide guidance and asked if custody is included in that. Barr thought that it would be useful for the Fed to provide guidance to the banking sector on safe custody of crypto assets and saw that with recent events, if you have a set of firms trying to operate outside of the regulatory perimeter, it can create enormous problems for investors. Toomey followed up saying that the SEC has put out guidance that would require issuing firms that custody crypto to put that crypto on their own balance sheet which is contrary to the way custody services are treated in every other category of assets. He thought banks have every reason to be concerned about this and asked if this would impose a significant cost on banks if they are required to put custodied crypto assets on their balance sheets. Barr said that banks are strong right now and said that publicly traded banks would need to comply with this rule in a way that is not required for the traditional custody of non-crypto assets.

**Sen. Reed (D-RI)** turned to Barr on the Volcker rule which prohibits Wall Street banks from making investments in hedge funds and private equity funds and said that there are some funds that were deemed too illiquid or too difficult to be dispensed with immediately so there was an extension, yet this disassociation or disinvestment still has not occurred 12 years later. He asked Barr if this will be an endless process and why this is not done. Barr agreed that the time has come for these divestments to occur and said that some firms were erroneously relying on a legal interpretation that would not require them to do those divestitures, which is incorrect, and clarified that it is time to get those divestitures done and some may need a small amount of time, but they will not see continued extensions. Reed turned to interest rates and asked why the biggest banks have been lagging in terms of sharing their benefits with their savers. Gruenberg said it was clear that the banking industry is trying to take advantage of the interest rates on the credit product side to increase earnings and added that the deposit side has lagged. Reed followed up talking about rent-a-bank schemes, where fintech companies come in and use banks as an intermediary to avoid usury limits and other restrictions, and asked Gruenberg what he is doing to stop these schemes. Gruenberg explained that when a bank partners with a third party, as a supervisory matter, the offering of services by the third party is treated as if the bank itself is offering these products and said that the banks are supervised accordingly. He said that the FDIC is closely looking at the lending activity to ensure that it is being properly underwritten and representative of a borrower's ability to pay, and in compliance with consumer protections requirements.

**Sen. Rounds (R-SD)** congratulated Gruenberg on his nomination and turned to Barr’s past comments on a holistic review of capital requirements, including a review of the SLR, the countercyclical capital buffer, and stress testing. He asked Barr when the review will be complete and if the Fed will commit to providing a transparent, formal and public process with a comment period for any resulting adjustments to SLR, the G-SIB surcharge, stress tests, or countercyclical capital buffer. Barr replied that the Fed is conducting the review now and that the Fed will be able to say more early next year. He said that the Fed would seek public comment before the Fed took any action on a final rule. Rounds turned to Harper on environmental risks and thought that there was problematic language regarding credit unions in agricultural areas. He added that this language was not in the final review and asked Harper if he would commit to avoiding similar problematic language in future strategic plans and commit to not punishing credit unions for supporting their local farmers, ranchers, and agribusinesses in their communities. Harper replied yes. Rounds went on that it has been widely reported that the CFPB is planning to shift liability for peer-to-peer (P2P) payments that consumers make to a scammer to banks, which would benefit scammers, and banks would have no insight into these fraudulent payments to be able to stop them. Rounds asked Barr if he was concerned that this would be harmful to bank safety and soundness given potential fraud losses and if there is any research on potential increased fees and costs to consumers if this is implemented. Barr replied that Reg E is implemented by the CFPB so it makes sense for the CFPB to figure out its proposal first and then they could understand the implications. He had no further insights right now. Rounds then brought up the FDIC approving bank deposit insurance rates to go up by two basis points and said that this could be harmful to community banks. Meanwhile, he added that the OCC recently approved a 40 percent reduction in assessments for OCC-chartered community banks and asked Gruenberg to explain his logic on the FDIC’s decision. Gruenberg said that the 2 percent was the subject of a careful analysis based on the FDIC’s analysis of recent crises. He acknowledged that the FDIC did have a tricky call to make here and opted for a 2 basis point increase which ensures putting the fund in a solid position.

**Sen. Menendez (D-NJ)** said that the collapse of FTX last week is the latest collapse in a series of high profile crypto collapses this year and thought that this should renew the call for Congress to take a serious look at crypto exchanges and lending. He asked if he was correct that there are no cryptocurrency firms backed by the FDIC. Gruenberg said that was correct. Menendez asked what can be done to combat misinformation about crypto being safe and insured. Gruenberg replied that this has been a priority for the FDIC and emphasized the importance of consumer confidence. He said that when the FDIC identifies companies engaging in misrepresentation, it acts forcefully asking these companies to cease and desist. Gruenberg added that the FDIC has enforcement tools it can use if the cease and desist is not followed. Menendez turned to reforming the CRA and highlighted the number of people whose first language is not English. He hoped that the regulators would encourage banks to offer more services in multiple languages which would help the banks and their communities. Menendez encouraged the Fed to place a Hispanic person in the vacant Fed President positions. He asked Barr what steps he has taken to implement reforms. Barr replied that there have been a number of positive steps taken and said that the Fed is considering receiving public input on the process itself.

**Sen. Tillis (R-NC)** expressed concern with Gruenberg’s nomination and pointed out that Gruenberg’s term is long expired, and he has remained at the FDIC despite that. He pointed to Operation Choke Point and the pushing out of Chair McWilliams. Tillis stated that nominees need to uphold the independence of agencies and believed that Gruenberg does not meet this requirement. Tillis turned to Barr on the safety and soundness of banks and believed that the upcoming Basel report will increase capital levels and asked Barr if he believed that capital levels are not strong enough. Barr replied that he is engaged in a holistic review right now and said that he can give a better answer at the beginning of next year. Tillis then asked what will ultimately tip the scales to a different conclusion about capital ratios and maybe embrace the Basel report. Barr replied that they are looking at all the factors and that the stress test is one important input into that. He added that they need to look at risks across the system. Tillis asked, if economic activity continues to slow and we increase capital requirements, is there a scenario where that is a good thing. Barr replied that he is not reviewing capital requirements thinking about what the right capital levels should be tomorrow, but how the Fed should set capital requirements over time.

**Sen. Tester (D-MT)** appreciated the commonsense approach the regulators are taking around crypto and referred to a hearing last year where he talked about changes to CRA that would benefit Native Americans and rural areas. He asked the regulators how the new CRA will ensure investment in these areas. Gruenberg replied that these were areas of high attention when creating reforms and discussed a statewide review of banks, which will include rural and Native areas even if it is outside the branch network. Hsu added that Native American issues are a priority at the OCC. Tester asked if they had seen any positive impacts on housing with the changes in the CRA. Barr believed that we would see increased community development and housing in rural America with the implementation of the CRA. Tester turned to the agriculture industry, saying that prices have increased dramatically as well as input, and asked what the regulators are seeing from community banks serving agricultural areas. Gruenberg replied that community banks have been doing well across the country including those in agricultural communities. Hsu echoed Gruenberg’s comments and added that the OCC is paying attention to drought. Tester asked Hsu’s comment about the geopolitical uncertainty as it applies to the commodity space and asked what commodity or commodities he is talking about. Hsu replied that it is a broad range.

**Sen. Lummis (R-WY)** remarked that the FTX situation is awful, yet not very surprising. She noted that the amount of leverage that FTX was offering to retail customers is illegal in the US and discussed Regulation W, which exists to prevent special transactions like those that happened between Alameda and FTX. Lummis added that her legislation with Sen. Gillibrand includes similar protections and would have prevented the situation with FTX. She said that it is obvious that Congress needs to regulate digital assets and emphasized that her legislation comprehensively addresses these issues in a balanced way. Lummis turned to Barr on Regulation W and asked why it is important to have transparency on affiliate relationships for banking regulation and why Congress should consider that for digital asset exchanges. Barr replied that Reg W is a very important rule within the banking sector, saying that we need to protect the insured depository from risks being transferred from the affiliate and protect consumers. He added that those limits on the transactions between banks and an affiliate are a foundational part of banking law. Lummis asked if a Reg W type regulation would have assisted in preventing or disclosing some of the concerns with FTX. Barr replied that he is not in the best position to answer since he only knows what it is in the press, but said in general, Reg W has served the banking industry very well.

**Sen. Warren (D-MA)** referred to the attacks on the CFPB not being under the appropriations process and asked the panel if their agency is funded under the annual appropriations process. All panelists said no. Warren stated that there is a good reason why Congress created independent funding structures for bank regulators. She asked Barr if the Fed’s independent funding structure provides security and certainty to the banks. Barr replied yes. Warren referred to the arguments from the Fifth Circuit Court and how other agencies' funding structures would be unconstitutional as well. She said that a slew of courts have already upheld the CFPB’s funding structure and this Fifth Circuit decision has no grounding in law. Warren pointed to how the Mortgage Bankers Association understands the financial stability risks of eliminating this funding structure and, in 2019, they warned that striking down the CFPB would have catastrophic consequences for the real estate finance industry.

**Sen. Kennedy (R-LA)** asked the panel their opinion on if any of them would hire Sam Bankman-Fried to manage a food truck or hire his girlfriend who apparently was trading billions of dollars to manage a food truck. He asked who in our federal financial services regulatory administrative state was watching FTX to ensure that no one at FTX was stealing people’s money. Gruenberg responded that FTX was not engaged with the banking or credit union industry. He added that folks at FTX were engaged with investment and trading activity and so in the first instance, Kennedy should probably engage with the SEC and CFTC. Kennedy turned to inflation and asked if Barr agreed with Professor Jason Furman’s belief that unemployment has to rise by five percentage points for a whole year to bring inflation down one percent. Barr thought that we would see softening in the economy but did not have as precise a prediction as Furman. Kennedy then asked Barr if he agrees with Larry Summer’s opinion that unemployment would have to rise to 7.5 percent and stay there for two years for inflation to drop to two percent. Barr repeated that he believes we will see softening but that he does not have a precise prediction. Kennedy was then curious about the impact of fiscal policy on inflation and Barr did not want to comment.

**Sen. Van Hollen (D-MD)** discussed FedNow and the necessity of real time payments right now, given the cost to consumers. He understood that FedNow will be ready by next summer and asked if that date is still on track and how many Americans would have access by then. Barr thought that FedNow will significantly improve banks’ ability to offer real time services and added that it will take time to add institutions that are positioned to offer these services from FedNow. Van Hollen continued on the volatility in the global economy these days and noted concerns from Secretary Yellen about the 2019 FSOC guidance on nonbank SIFI designation. He asked if they also had concerns about the guidance and if they, as FSOC members, would support repealing that guidance. Gruenberg, Harper, and Hsu all said yes. Barr said that it would be useful to revisit the guidance and ensure that it is working and taking risk in the system into account. Van Hollen turned to cryptocurrencies and the collapse of FTX and asked if it is better to regulate or legislate. He noted that some make the case that regulation would normalize an area where there is inherent risk and create the false impression that investment in this space is safer than it is. Hsu replied that the devil is in the details of regulation. Gruenberg said that regulation will be necessary one way or another for crypto activity, which will mainly fall to the SEC and CFTC since it is mostly trading and investment activity. He added that stablecoins are a bit more challenging and may require legislation. Harper agreed that regulation is needed in this area and said that transparency is very important here. Barr suggested that the market regulators are the first place to start with regulation and thought that there was a need for a prudential framework for stablecoins with federal approval.

**Sen. Hagerty (R-TN)** wanted to continue the conversation on the FTX collapse and said that crypto is not beholden to specific laws inside or outside of America. He noted the failure of Congress to take action sooner and thought that we should focus on thoughtful and accelerated efforts to provide clear incentives for companies to domicile here and prevent future losses. Hagerty asked if there were thoughtful regulations would that encourage crypto companies to operate inside the US. Hsu replied that there are some basic foundational issues with crypto technology and the industry that are not sound and need to be addressed, like lack of clarity around ownership, and said that the state of the crypto industry is not mature enough at the moment. Hagerty turned to Barr on raising capital requirements on mid-sized banks with a heightened leverage requirement and asked why the Fed is reversing course now and considering punitive, new leverage and capital requirements for regional banks that could impede their ability to support the economy. He asked if Barr agreed that raising capital requirements now is not counter cyclical. Barr responded that the Fed is conducting a holistic review right now to make sure that the capital rules are fitting well together, and they are trying to create a capital rule that will work for the long term. Hagerty asked if increasing capital requirements right now in the current environment would be procyclical or countercyclical. Barr answered that it is important to have capital rules that are good for the whole cycle.

**Sen. Smith (D-MN)** discussed climate change, saying that it can create many risks in the economy. Smith asked Gruenberg and Hsu about their decision to issue draft principles to help larger banks manage climate-related risks and asked them to share the general reception they have received so far. Gruenberg replied that the industry has been receptive to guidance from agencies on managing the risks of climate change and saw this as an initial effort. He believed it was important for the OCC, FDIC, and Fed to act together. Hsu added that for smaller banks, there has been a bit of variation in response to the proposed guidance and said that there are risks and opportunities to manage with climate risk. Barr expected to join the OCC and FDIC on issuing climate guidance for firms that have over $100 billion in assets and added that the Fed is engaged in a pilot on climate scenario analysis that will be conducted next year. Smith believed that having clear input from banks of all sizes is important. Smith had a QFR on bank consolidation.

**Sen. Moran (R-KS)** was dissatisfied with the supervisory appeals process at the FDIC and briefly discussed this issue with Gruenberg. Moran then asked if there is value in having someone independent or neutral compared to the FDIC board. Gruenberg replied yes, adding that this is why there is an ombudsman on the Appeals Committee. Moran turned to the Federal Housing Finance Agency's (FHFA) tangible capital rules, saying they are inconsistent with the federal prudential regulators capital rules for accessing advances from the Federal Home Loan Bank (FHLB) system. He asked if there is a desire to align those capital rules and asked about a potential waiver process. Gruenberg replied that FHFA has a requirement that if a bank has negative tangible equity under GAAP accounting, then the bank is not allowed access to new FHLB loans until it addresses its negative tangible equity. He went on that the banks have regulatory capital, which does not include the unrealized losses under GAAP accounting. Gruenberg added that the FDIC is engaging with FHFA on this. Moran asked if Gruenberg thought this would be a problem for banks to get FHLB loans. Gruenberg responded that they are looking for the institutions to address the underlying issue, which is the unrealized losses and their negative capital position under GAAP to gain access to the loans. Moran asked if there is a process where a waiver is attainable through the prudential regulators as FHFA suggests. Hsu replied that this is addressed through the regular supervisory process and that they see it as a risk management issue, adding that the alignment question is a question for FHFA. Harper thought it was important to remember that when liquidity is provided by a FHLB, there are assets pledged as collateral and as the insurer, they could have a higher liquidation cost if the institution failed.

**Sen. Ossoff (D-GA)** asked Barr what the most significant threats to financial stability are. Barr mentioned earlier that the Fed is looking at risks in the nonbank financial sector, risks abroad, crypto risks, interest rate and liquidity risks, and credit risks. Ossoff asked how confident Barr is that regulators have adequate visibility into the potential exposure in non-traditional financial institutions to risks that could pose systemic threats to financial stability. Barr replied that the Fed has good insight into the banking system and the relationship with banks and other entities, but they do not have good visibility into what is happening in the nonbank sector, mentioning how they have more information about hedge funds than they used to have but more information would be useful. Ossoff asked if Barr shares Yellen’s concerns about the loss of liquidity in the Treasury market. Barr agreed that we are seeing higher volatility in Treasury markets and with that increased volatility has come a reduction in liquidity and said that the Fed is watching this very closely. Ossoff asked if Barr was worried about the same issues as Yellen in this space. Barr said that the Fed is very attentive to issues throughout the financial sector, including the Treasury market. Ossoff then asked Gruenberg about the most significant threats to financial stability. Gruenberg agreed with Barr’s answers. He noted the nonbank financial sector and potential leverage there and the risks that it can pose. Ossoff asked who the counterparties for that leverage are. Gruenberg answered that the counterparties are the banks but said that there is not the clearest line of sight here.

**Chairman Brown** heard a lot about crypto risks today and reversal of Trump regulators who let crypto run wild. He thanked the regulators for being here today.

Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions

House Financial Services Committee

November 16, 2022

**Opening Statements**

[**Chairwoman Waters (D-CA)**](https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409921)welcomed the regulators to the Committee and congratulated Gruenberg on his nomination to serve as Chair of the FDIC. She looked forward to the Senate promptly confirming him. Waters believed this hearing was timely, saying that our financial system is rapidly evolving and mentioned the dangers of crypto operating in the shadows without any federal oversight, pointing to the recent events with FTX. She was pleased that the agencies rejected the harmful Trump-era proposed CRA and are working on a joint proposed CRA reform. Waters mentioned the regulators’ work on climate-related risk and bank mergers. She believed that any mergers that do not improve and serve a community should be rejected. She appreciated steps regulators have taken to ensure banks are cautious and mindful of the risks posed by digital assets. Waters wanted to know what more the agencies are doing to monitor the impact of emerging technologies and AI and promote responsible innovation. Lastly, she was curious if the regulators supported legislation in the digital asset space, specifically with regard to stablecoins.

[**Ranking Member McHenry (R-NC)**](https://republicans-financialservices.house.gov/news/documentsingle.aspx?DocumentID=408472)thanked Waters for scheduling a hearing on FTX next month and said that the FTX collapse has been a ‘dumpster fire’ and added that Chair Gensler is more interested in ‘chasing headlines than bad actors.’ He clarified that Congress must develop a clear regulatory framework in the digital asset space, especially for trading platforms. McHenry turned to the regulators saying that it has taken almost a year for Barr to be confirmed, Hsu is still in an acting role with no nominee in sight, and Gruenberg was finally re-nominated after being on an expired term for four years. He said that this does not inspire a lot of confidence and emphasized that their agencies need to be focused on safety and soundness in the current environment. McHenry expressed concern about the Treasury and mortgage markets and went on to say that we need to ensure consumers and the economy are protected while focusing on growth. McHenry believed that during this inflationary time, the regulators are actually making the situation worse. He expressed concerns about the Fed revisiting the capital framework and mentioned the reforms to the Bank Merger Act, which he believed was impacting competition. McHenry clarified that this conversation with the regulators is not over and wanted to make sure that the focus is on the American people and growing the economy. He said that next Congress, he will be holding the regulators accountable.

**Rep. Perlmutter (D-CO)** mentioned crypto, saying that a couple trillion dollars of wealth has evaporated and as we are fighting inflation, he was concerned about what happens next. He was also interested in the regulatory reviews on diversity and inclusion and environmental considerations.

**Rep. Luetkemeyer (R-MO)** discussed the impact of inflation on Americans and said that the regulators have instructed financial institutions to monitor climate risk rather than help Americans afford gas. He questioned the need for new bank capital requirements, saying that banks passed the real-world stress test of the pandemic and passed with flying colors.

**Witness Testimony**

[**The Honorable Michael S. Barr**](https://democrats-financialservices.house.gov/UploadedFiles/HHRG-117-BA00-Wstate-BarrM-20221116.pdf)**, *Vice Chair for Supervision*, *Board of Governors of the Federal Reserve System,*** explained that his priority is making the banking system safer and fairer and that his testimony would offer an overview of the banking system’s current conditions and highlight efforts to monitor and mitigate vulnerabilities. First, he noted that capital and liquidity positions remain above regulatory requirements, but we must ensure we are keeping pace and pointed to recent events in the crypto markets as risks to investors. He then moved on to how the Fed is considering improvements to the regulatory capital framework and outlined the principles he would be guided by. Barr discussed the ANPR on enhancing regulators’ ability to resolve large banks in an orderly way as well as the regulators’ review of the merger process. He turned to the need to monitor risks related to crypto activity and how this activity requires effective oversight that includes safeguards to ensure that crypto companies are subject to similar regulatory safeguards as other financial services providers. Lastly, Barr discussed their work on climate-related financial risk with their pilot on climate scenario analysis and operational resilience.

[**The Honorable Martin J. Gruenberg**](http://docs.house.gov/meetings/BA/BA00/20221116/115200/HHRG-117-BA00-Wstate-GruenbergM-20221116.pdf)**, *Acting Chair, Federal Deposit Insurance Corporation,*** noted that his oral testimony would focus on the state of the banking industry and the outlook for the industry. He said that the industry has produced positive results this year and it remains well-capitalized and highly liquid. Gruenberg remarked that 14 new banks have opened as of October 2022 and no banks failed during the pandemic. He went on to say that rising market rates and strong loan growth supported an increase in the banking net interest income. However, Gruenberg said that rising interest rates and longer asset maturities also resulted in unrealized losses on investment securities held by banks and said that as of the second quarter of 2022, banks reported $470 billion in unrealized losses and the FDIC expected this trend to be an ongoing challenge. In summary, he said that despite favorable performance metrics, the banking industry continues to face significant downside risks on multiple fronts that need to be watched in the coming quarters. Gruenberg noted that his written testimony provides an overview of the condition of the banking industry and the FDIC’s Deposit Insurance Fund (DIF). He then updated the Committee on five key policy priorities for 2022: strengthening the Community Reinvestment Act (CRA); addressing the financial risks that are likely to affect banking organizations and the financial system as a result of climate change; reviewing the bank merger process; evaluating the risks of crypto assets to the banking system; and finalizing the Basel III capital rules. He also discussed the FDIC’s efforts to support MDIs and Community Development Financial Institutions (CDFIs). Finally, Gruenberg described the FDIC’s work to strengthen cybersecurity and information security within the banking industry and their recent return to in-person bank examinations and other in-person activities at every level of the FDIC.

[**The Honorable Todd M. Harper**](http://docs.house.gov/meetings/BA/BA00/20221116/115200/HHRG-117-BA00-Wstate-HarperT-20221116.pdf)**, *Chair, National Credit Union Administration,*** began by outlining the core goals in the NCUA’s five-year plan and then went on to discuss the state of and factors impacting the credit union system. He noted that while COVID and rising interest rates have impacted credit union performance, credit unions, the Share Insurance Fund, and the Central Liquidity Facility (CLF) have all remained on solid footing. Harper then discussed the NCUA’s efforts to strengthen capital standards, improve the examination process, enhance cybersecurity, protect consumers, preserve Minority Depository Institutions (MDIs), and advance diversity, equity, and inclusion (DEI). He moved on to the recent rulemakings and guidance from the NCUA on multiple issues, including member expulsion, cyber incident notification, use of distributed ledger technologies, and more. Harper then outlined the two legislative requests from the NCUA on permanently adjusting the CLF agent-member requirements to allow agent members to purchase capital stock for a subset of credit unions served as well as the restoration of statutory examination and enforcement authority over third-party vendors.

[**Mr. Michael J. Hsu**](http://docs.house.gov/meetings/BA/BA00/20221116/115200/HHRG-117-BA00-Wstate-HsuM-20221116.pdf)**, *Acting Comptroller, Office of the Comptroller of the Currency,*** emphasized the mission of the OCC and noted the four priorities that he outlined for his agency last year, including (1) guarding against complacency by banks, (2) reducing inequality in banking, (3) adapting to digitalization, and (4) managing climate-related financial risks. He was pleased with the progress of the agency and provided an update on each area. Hsu mentioned overdraft fees saying that the OCC has encouraged banks to reform overdraft and NSF fees. He referred to the updates for analyzing mergers under the Bank Merger Act that the OCC is working on with the Fed and DOJ. He stated that the OCC is focused on safety and soundness of the banking system and referred to the announcement on the creation of an office to monitor bank-fintech relationships. Hsu turned to crypto, saying that the OCC has adopted a careful and cautious approach. He turned to climate related issues and said that it is not the OCC’s role to pick winners and losers, their focus is on risk management.

**Member Questions**

**Chairwoman Waters (D-CA)** turned to Barr on the recent failure of FTX and believed it was important for Congress to legislate and regulators to update the rulebook to implement further safeguards. She said that the Fed signed on to the PWG report and an FSOC report on digital assets which urged Congress to enact legislation to address risk in this space, including those from stablecoins. Waters asked if Barr approved of the overall approach, she and McHenry have taken to possible stablecoin legislation and asked if this is an area that Congress can afford to wait or if there is urgency to enact legislation. Barr was encouraged by the stablecoin legislation and thought it is an urgent area to work on, saying that stablecoins present an important and urgent risk for them to address. He added that stablecoins are a form of private money and said that it can produce run risk and financial stability risk if not appropriately regulated so he thought it was important to have stablecoin legislation to address that. Barr believed we needed strong federal oversight of stablecoins. Waters moved on to Hsu, saying that the failure FTX may have impacted some banks, but most banks seem to be fine due to steps from the OCC and others, but she believed that more needs to be done. She said that customers impacted by FTX’s failure will have to wait for years for their assets to be returned due to the bankruptcy proceedings. Waters then asked, when it comes to the custody of consumer funds, did Hsu think that a digital asset wallet or other entity should be allowed to commingle its funds with the assets of its customers. She then asked if such assets are commingled, does that allow for the wallet or exchange to lend out its customer assets for other purposes. Hsu replied no and said that co-mingling of customer funds with house funds have proven to be a very difficult risk to manage and said that at the OCC, they believe that any crypto activity done within the national banking system needs to be safe, sound, and fair. He added that they want to ensure that consumers are protected, and that there is financial stability.

**Ranking Member McHenry (R-NC)** discussed the Fed’s holistic review of the capital framework that is happening this next year and had concerns about the Treasuries market. He then asked Barr if he agreed that increased capital requirements for banks, like the Supplementary Leverage Ratio, have impacted banks’ ability to provide liquidity in the Treasuries market space. Barr was attentive to these concerns and said that the Treasury market is experiencing higher levels of volatility which leads to lower levels of liquidity. He said that the Fed is paying attention to these issues and that this is occurring for multiple reasons. Barr said that the Fed has put in place a backstop facility for repo transactions and foreign official repo transactions which are designed to help mitigate market stress. McHenry asked what Barr is doing to address the private sector’s ability to provide liquidity using the Treasuries market. Barr said that the Fed is looking at the enhanced SLR and other capital requirements and added that the SEC is looking at participants in the market for Treasury securities as well. McHenry said that the Fed has a large remit to address capital standards and asked if they have some bearing on liquidity in the Treasury marketplace. Barr said that they are examining that issue and looking at the capital framework with this in mind. McHenry hoped this could be addressed before a harmful event happens. Barr ensured that the Fed is using all the tools in its power to address the resiliency of the Treasury market.

**Rep. Maloney (D-NY)** referred to the CARD Act, which was enacted in 2009, and mentioned her overdraft legislation that would add to the CARD Act. She stated that overdraft fees penalize consumers and expressed concern that many banks still have not made voluntary changes in the overdraft space, which is why she has introduced the Overdraft Protection Act. Maloney said that this legislation passed the Committee in July. She asked Gruenberg how the practice of overdraft fees has changed over time. Gruenberg agreed that overdraft fees are an issue, and that the banking industry has become increasingly aware of this. He said that the FDIC uses the examination process to oversee the overdraft fee process to ensure that the fees are transparent, in line with the regulatory requirements, and that customers have to opt-in to the service. Maloney asked if there are instances where the FDIC might classify some overdraft programs as an unsafe or unsound banking practice. Gruenberg replied that it is possible, and it depends on how the process is implemented. Maloney asked Barr if the FTX event impacts the safety and soundness of the banking system. Barr replied that the recent events have slightly impacted the banking system, but in the aggregate, the impact has been relatively muted, and they are not seeing any systemic risk as a result. Maloney asked for Barr’s position on allowing our financial system to be exposed to such volatile products that can hurt consumers. Barr advocated for guardrails here to protect consumers. Maloney asked if crypto should be regulated. Barr replied yes, regulators can use their existing authorities and Congress can legislate to strengthen oversight of the sector as well.

**Rep. Wagner (R-MO)** said that the US Treasury market is the biggest, deepest, most important bond market in the world and historically, it has been a safe haven for investors during market crises given its stability and liquidity, and as a result, Treasury market conditions impact borrowing costs at home and around the world. She said that the primary goal of reform should be to enhance liquidity capacity and resilience and referred to an SEC rule proposal that would impose new rules on clearing agencies. Wagner referred to a speech by Fed Governor Bowman on how the flood of reserves in the banking system have hampered the distribution of capital, and asked Barr if addressing this issue with leveraged ratios could improve market functioning and financial stability. Barr replied that the Treasury market is robust and resilient and admitted that he had not read Bowman’s specific remarks. He said that the Treasury market reform effort is broad based, with the Fed and other agencies, and that it has already taken steps to establish the stability of the market. Wagner believed that the SEC is pushing back against the Fed proposals. Barr believed that the Fed proposals are enhancing the Treasury market. Wagner moved on, asking if increased capital requirements harm banks’ ability to provide credit to consumers and businesses. Barr replied that we have a strong banking system in the US due to a strong regulatory framework, including strong capital requirements. Wagner had questions for Gruenberg that she would submit to the record.

**Rep. Velazquez (D-NY)** asked what guardrails the Fed is planning on using to address the crypto market. Barr replied that this collapse is really a question for market regulators but said that some number of banks are offering traditional services to crypto. He advocated for clear guardrails in this area to regulate risk. Velazquez asked if legislation would be helpful. Barr thought that stablecoin legislation and agency oversight would be beneficial. Velazquez turned to the FSOC 2021 report on financial institutions' use of emerging technologies, specifically cloud computing, and asked how the banking industry’s reliance on cloud storage changes the industry’s risk profile. Barr thought that over time this reliance on the cloud will require more attention and said right now it is a small percentage of banks' engagement but predicted it will become more important over time. He added that the Fed is always attentive to third party service relationships and that they can access information about these relationships to make sound decisions. Velazquez turned to Gruenberg on the FDIC’s Unbanked and Under-banked Survey and asked about the trends of unbanked households being less likely to use online payment companies than banked households and that they were more likely to use these companies for things like paying bills or saving money. She asked Gruenberg what he believes these trends tell us. Gruenberg said that the survey found that banked and unbanked households utilized payment services in different ways.

**Rep. Lucas (R-OK)** said that Oklahoma is a commodity driven economy and said that the agricultural and energy sectors are vital to the state and worried about capital being driven away from energy companies. He referred to the Fed’s climate scenario analysis pilot and asked Barr to further explain the program and asked if the pilot could have any supervisory or capital implications in the future. Barr replied that the Fed’s role in this area is important but narrow and said that the scenario analysis does not have supervisory or capital implications; it is designed to understand banks’ risk management approach. Lucas discussed the Network for Greening the Financial System (NGFS) and the OCC’s membership and asked if Hsu agrees that U.S. regulators should align with NGFS’s stated goals and asked what the OCC’s role is in regulating climate change. Hsu echoed Barr, saying that the OCC will stay in its safety and soundness lane when it comes to climate and said that the OCC is focused on the large banks here. Lucas turned to Gruenberg on market volatility and asked what regulators should be focused on with respect to the resiliency of the central counterparty clearing houses (CCPs). He also asked if the FDIC has worked with the CFTC and SEC here. Gruenberg replied that there has been interagency coordination on CCPs and said that supervision of CCPs is critical given their footprint. He went on that you need a capacity to strengthen the supervision of CCPs and have the capability to manage an orderly failure. Lucas noted that these are issues that the Committee will dwell a great deal on next year.

**Rep. Sherman (D-CA)** stated that he has been calling for a ban on crypto for a decade and was concerned that the regulators are discussing “guardrails,” calling this vague. He said that Basel has imposed real standards and asked if the regulators are willing to commit to the standards like the ones at Basel. All regulators raised their hands. Sherman said that over a billion dollars have been lost just in the past six months and turned to Barr on the prospect of the Fed having a system for wiring funds that are safe from hackers, adding that while the UK prevents this effectively, the Fed refuses to do it. Sherman wanted the Fed to meet with the people that have been impacted by this. He referred to Sen. Ossoff and Rep. Wagner’s questions on the liquidity of the Treasury market and asked Barr if there is thought being given to adjust leverage requirements to help incentivize more intermediation in the Treasury market. Barr replied yes and said that the Fed is looking at a wide range of measures with respect to the resiliency of the Treasury market, including the enhanced SLR, and has set up backstops if need be.

**Rep. Sessions (R-TX)** discussed cashier’s checks, saying there is only a seven-day hold on cashier’s checks over $5,525, and said that banks are required to make the money available after one day. He said that this has become an open issue because when the person accepting the check suggests it may not be real, then they have to quickly find out where the check came from to cash the check. Sessions was interested in Barr’s opinion on this, wanted this to be addressed rapidly, and would send him a letter on this. Barr was happy to take a look at this and said that at a high level, the Fed is concerned with fraud at any level in the payments system and referred to Reg CC. Sessions believed that banks want to be able to use their experience to avoid this as it is happening on a regular basis.

**Rep. Scott (D-GA)** said that the FHFA’s policy on tangible capital limits access to Federal Home Loan Bank (FHLB) advances to banks that have negative, tangible book value, and while these banks are considered well capitalized, he was concerned that this is an inconsistency, and it threatens to transform a small market issue into a serious problem. Scott was interested in learning about what each of the regulators here can do to avoid turning what are unrealized net losses into a real supervisory issue that will disproportionately impact community banks. He wanted to know what the regulators can do to help. Scott asked if this is an issue and what steps the regulators are taking to ensure that investments made by community banks in US Treasuries, that may have resulted in unrealized losses, do not become a supervisory crisis. Barr understood that this is an issue that a number of organizations have voiced concern about and wanted to ensure that community banks are thriving. He said that FHFA has the first instance of authority to say whether it is safe for FHLB to lend and explained that the Fed has more of a supervisory role and looks at how banks are managing their interest rate risk and liquidity risk. Scott asked if their agencies are putting a regulatory process in place so a community bank can seek a waiver from FHFA’s tangible capital rule. Gruenberg said if it is a blanket waiver, then no, but agreed there is a significant underlying risk management issue relating to unrealized losses on the balance sheets of these banks.

**Rep. Luetkemeyer (R-MO)** asked if the OCC assisted with the CFPB’s internal analysis on the FDIC board’s bylaws. Hsu replied no. Luetkemeyer believed that Chopra had lied about this, and then asked if the OCC conducted its own legal analysis on participating in the vote if they did not rely on the CFPB. Hsu replied no, the OCC was focused on the policy, which is why he voted for the RFI. Luetkemeyer believed that Hsu did not follow the process, Hsu disagreed. Luetkemeyer turned to Gruenberg on Operation Choke Point and said that the FDIC created a list of high-risk merchants and mentioned rent-a-banks. He continued that Gruenberg was Chairman when Choke Point occurred and asked if he would bring this operation back and limit financial access for legally operating industries. Gruenberg replied that Operation Choke Point is represented as pressuring banks not to serve customers that are complying with state and federal law and added that as long as the bank has appropriate management capability, then it is the policy of the FDIC that banks should be able to serve any such customer. Luetkemeyer assumed his answer was no and turned to a joint statement from the regulators pertaining to the ATM industry. He read from the statement, asking if the regulators agreed that, as a general matter, the agencies do not direct banks to open, close, or maintain specific accounts, the agencies continue to encourage banks to manage customer relationships and mitigate risks based on customer relationships, rather than decline to provide banking services to entire categories of customers. All of the regulators agreed.

**Rep. Green (D-TX)** discussed the decline of African American owned banks and said that less than 20 of the over 4,000 FDIC insured-banks are African American MDIs. He found this unacceptable and asked Gruenberg if he agreed that this was unacceptable. Gruenberg agreed. Green asked if the other regulators concurred. Barr, Hsu, and Harper concurred. Green said that the question is what to do about this and asked Gruenberg to answer. Gruenberg replied that the FDIC has a statutory obligation to support the development of MDIs, in particular with regard to African American owned institutions, and said that this is a priority for the FDIC. Barr replied that he would be happy to continue the Fed’s work on supporting MDIs.

**Rep. Barr (R-KY)** asked VC Barr about the Fed’s capital review and was concerned that this undertaking might result in increased capital requirements. He asked what impact more capital requirements might have on deploying capital to repair supply side deficiencies and address inflation. VC Barr replied that in a broad sense, the Fed is looking at this holistic review of capital with a view to the long-term and any effort the Fed undertakes would go through the normal rulemaking process. He said that the reason we have such a dynamic banking system is because of the banking system’s resilience and having strong capital requirements allows banks to lend in good times and in bad. Rep. Barr agreed that banks are very well capitalized but underscored that there is research out there saying that there is a balance to be struck here and that any overly strenuous capital regime could be harmful. Rep. Barr turned to climate risk and asked VC Barr if anyone at the Fed has climate policy expertise. VC Barr replied that the Fed is focused on financial risk, not climate policy. The other regulators echoed VC Barr’s comments. Rep. Barr wanted reassurance from all the regulators that the agencies will not discriminate against carbon intensive industries. VC Barr replied that the Fed will not discriminate against any companies. Rep. Barr stated that he will be watching the regulators on this and hold them to it.

**Rep. Cleaver (D-MO)** thought that CRA was incredibly important and discussed his legislation that would create additional rating categories. He asked Barr how the rating system could be improved, pointing to how some institutions' scores were not impacted despite not following fair lending laws. Barr replied that the CRA is vital to revitalizing communities and said that the CRA should take into account discriminatory practices. He supported the change in the CRA that would take Cleaver’s concern into account and result in downgrades. Gruenberg replied that the top priority of the banking agencies is reforming the CRA. Cleaver assumed that the federal agencies agreed with him and thought this could be done without congressional action and asked for a timeline of when this CRA reform could be put in place. Gruenberg hoped it would be as soon as possible and emphasized it is a priority to finalize the rulemaking.

**Rep. Williams (R-TX)** discussed Basel III capital standards that the agencies committed to this September and did not know why the US was committing to international standards that would set US financial institutions back. He asked Barr why the US should take an additional step to hold capital. Williams noted that when interest rates are raised and you hold capital, it creates problems for people like him (i.e car dealers). Barr replied that the Fed is undertaking a holistic review of capital requirements, which includes the Basel III adjustments and believed these adjustments would make the US financial system safer and sound. Williams turned to Gruenberg on his October 2022 speech where he said that the FDIC is not responsible for climate policy and said that Operation Choke Point was personal to him. He asked what proactive steps the FDIC is taking to ensure that the agency will not determine what sectors financial firms do business with. Gruenberg understood that this is a particular concern for Texas bankers, pointing to his attendance at the American Bankers Association Conference in Texas, and stated that climate change risk is not incorporated into the FDIC’s supervisory program.

**Rep. Meeks (D-NY)** expressed his interest in the upcoming December hearing on FTX and was concerned about federal legislation preempting state regulation, saying that this situation could have been prevented if they had been registered in New York. He continued that the CRA was basically civil rights legislation and was wondering whether or not, as they contemplate new CRA rules, they are taking into account the role of MDIs and CDFIs in LMI communities and communities of color. Barr agreed that MDIs and CDFIs play critical roles in communities and said that there are provisions that acknowledge their special role in the space. Meeks noted MDI’s and CDFI’s great track record on economic development and asked about their agencies’ approach to advisory groups for these institutions.

**Rep. Hill (R-AR)** asked if it is currently legal for a bank to charge a non-sufficient funds (NSF) fee and return a transaction when a customer has insufficient funds. Gruenberg said yes. Hill agreed that it is and said he sent Gruenberg a letter this morning because he wanted to explore this further. He discussed how FDIC’s examiners seem to be taking on a new interpretation of ‘unfairness,’ and asked if charging multiple NSF fees for repeated transactions is not reasonably avoided by customers. Gruenberg said that it depends on how the bank handles the issue and that Hill is right that the bank can charge an NSF fee if there is a check written for an amount larger than what is in the account. Hill thought that there is regulation by enforcement going on and asked if there will be a public APA rulemaking here. Gruenberg said that the FDIC did issue a financial institution letter. Hill said that this is a “gotcha situation.” Gruenberg assured Hill that he would respond to his letter. Hill asked if Hsu sees it this way as well. Hsu said that he would have to check.

**Rep. Perlmutter (D-CO)** wanted to focus on inflation and asked what kind of loan losses are expected and what kind of cushions there are to deal with foreclosures and failures. Barr replied that banks are resilient and balance sheets are strong going into this next quarter. He said that the Fed is paying attention to loan losses and the commercial real estate and residential housing sectors in particular. Perlmutter asked about concerns of contagion in the banking system from losses in the crypto world. Gruenberg replied that bank exposure to the crypto market is very limited. Perlmutter asked about the stock and real estate market. Gruenberg replied that the FDIC is paying attention to the real estate market as interest rates rise. Perlmutter asked about loan loss reserves. Gruenberg replied that there is a large accumulation of unrealized losses on the books of the banks from securities they are holding on their balance sheets. However, he added that the industry has strong liquidity currently, so they should be able to handle it in the short-term. He added that depending on future economic events, more financial stress could force institutions to sell assets to get liquidity.

**Rep. Huizenga (R-MI)** described the FTX situation as Enron meeting Bernie Madoff. He asked about future interagency policy sprints on banks’ involvement in digital asset activities and how the Fed plans to continue to work with other prudential regulators. Barr replied that the agencies are working together to examine prudential issues that might arise when banking organizations are engaged in a broader range of activities, including crypto-related activities. He said each agency has taken steps to understand what is currently happening in the banking space and said that the agencies have been working together to provide greater clarity to banks on guardrails that need to be in place. Huizenga asked if there were any future plans. Barr expected to provide greater clarity to firms engaged in this space. Huizenga asked how Barr would explain that limiting stablecoin issuance to banks would not disincentivize the innovation that led to the development of stablecoins. Barr thought it critical that there is strong federal oversight and regulation of stablecoin activities. Huzienga asked if Congress should pass legislation here. Barr replied yes.

**Rep. Foster (D-IL)** discussed the Fed’s holistic review of capital requirements and hoped Barr would consider recent international experience with contingent capital instruments. Foster noted that Dodd-Frank provided FSOC with the authority to require SIFIs to issue contingent capital instruments as part of their capital. He thought this was important for many reasons as it prevents contagion, provides a market-based incentive for bond traders to look at the books and risk posture of large banks, and it provides market-based incentives for banks to adopt less risky postures. He thought this could address bank failures and mentioned that the US regulators have not used this authority, but other regulators have with very positive results. Foster asked what Barr’s view of contingent capital requirements was and if he would look at them as part of his review. Barr replied that if you look at the different types of these instruments, the current framework already has a form of these instruments with respect to gone concern capital, saying that, when there is a resolution of a G-SIB, there is a long-term debt requirement at the G-SIB level that is in effect converted into equity in the new institution when a bridge bank is created. Foster did not think this was a useful market signal. Barr said it does not perform the same function as going concern arrangement, adding that there is some risk with CoCAS, and that as you get close to those buffers, you might see runs or contagion, which is why it is appropriate to remain cautious of. Foster thought there were trigger mechanisms that have been developed to avoid this.

**Rep. Davidson (R-OH)** discussed tech efforts at the FDIC and recalled that the head of the tech office left earlier this year and asked Gruenberg to discuss the slow down at this office and how this is impacting FDIC-regulated banks. Gruenberg replied that the people working in this office have a forward-looking approach and said that there is a new director of the group. He added that the group is incorporated into their CIO organization. Davidson highlighted the CFPB’s 1033 rulemaking, saying that he looks forward to seeing where that goes because of the fact that it will provide clarity on fintechs, which he said can be great if consumers can own their data. Davidson turned to Barr and his stance that crypto should be regulated like traditional finance. Davidson asked how this applies to the FTX situation since they were largely offshore and how the situation undermined traditional finance channels. Barr was not aware of the underlying facts of FTX but said that the issues that are being raised are services that cannot be done in a bank. He thought that the basic concepts are the same so you want a system that does not permit that kind of activity to occur. Davidson said this would be a horrible time to end self-custody.

**Rep. Beatty (D-OH)** announced that there is a brand-new MDI opening up in her district and thanked the FDIC for its work. She turned to Harper on a recent NCUA paper by the Chief Economist on minority borrowers and paying higher interest rates on those loans. Beatty asked Harper to explain these findings and what the NCUA is doing to improve these findings. Harper replied that the study was telling and said that this shows that the NCUA needs to enhance its fair lending practices and risk focused examinations.

**Rep. Rose (R-TN)** believed that now more than ever, Chair Gensler needs to come before the Committee to discuss what he knew about the FTX situation. He turned to Gruenberg on the FDIC vote to raise deposit insurance assessment rates by two basis points and said that the change amounts to a 54 percent increase in the current average assessment rate. He continued that the FDIC said the changes will remain in effect until the DIF reserve ratio reaches the FDIC goal of 2 percent, even though the statutory minimum is 1.35 percent. Rose asked what the FDIC’s plan was to reduce the DIF assessment once the target is met. Gruenberg clarified that the FDIC has to maintain a minimum reserve ratio for their DIF and they are required to implement a restoration plan if it falls below the minimum which can take up to 8 years. He admitted that this was a tricky call whether to bump up rates or leave it to correct itself. Gruenberg said that the short-term goal is to reach the 1.35 threshold in the 8-year period.

**Rep. Vargas (D-CA)** asked whether Dodd-Frank has been helpful over the past 2-3 years. Barr replied that Dodd-Frank has been helpful in providing a resilient base for the financial system and believed that it has made the banking system fairer and safer. Gruenberg agreed and said that capital and liquidity requirements were strengthened under Dodd-Frank and it put us in a better position to face the pandemic stress. Harper agreed with the previous comments. Hsu agreed as well and added that the banking system is dynamic and that we have to keep up with risks. Vargas said that the issues of financial risk and climate risk are interconnected. He then noted his work in insurance and how their actuaries believed that climate change created risk. Vargas said Barr has said carefully that he is looking at financial risk, not climate risk, and asked him to discuss this. Barr replied that this is a question the agencies are working on and mentioned the climate scenario analysis pilot exercise to ensure that financial institutions are building the appropriate risk frameworks. Vargas closed by noting the lack of cheerleading from Republicans on crypto today and hoped they could put regulation in place.

**Rep. Mooney (R-WV)** believed that the agencies do not have the authority or ability to be experts on climate policy. Mooney asked how the regulators are ensuring that any guidance their agencies issue is not construed as a directive for financial institutions to not lend to fossil fuel companies. Barr replied that the Fed has made clear that it is not in the business of telling banks who to lend to. Gruenberg answered that the FDIC has only proposed guidance, not finalized guidance, and pointed out that the industry has experience managing the risks of climate change on its own. Harper replied that the NCUA is ensuring that any guidance to credit unions does not put a weight on the scale of who to lend to. Hsu said that the OCC is taking a similar position to the other agencies. Mooney emphasized that coal is critical to West Virginia’s economy.

**Rep. Lawson (D-FL)** discussed weather and climate-related events saying that these events are on the rise and asked how community banks can best implement risk management. Hsu replied that most community banks have been successful in handling climate events but are concerned about the recent severity of these weather events. He said it was fair to say that there is a lot of learning on how best to approach this. Lawson discussed the racial wealth gap and asked how racial equity factors into the agencies’ guidance and priorities. Barr answered that it is important to have a banking system that works for everyone, one that is inclusive, and mentioned efforts like BankOn and FedNow to ensure that the banking and payments system are supporting Americans like they should. Gruenberg agreed with Barr and added that the agencies have a responsibility to enforce fair lending and said that expanding access to the banking system has been a priority to the FDIC. Harper highlighted that the NCUA is working through two rulemakings regarding appraisal bias, one on automated evaluation models and the other on reconsideration of values.

**Rep. Steil (R-WI)** wanted to discuss bank capital requirements and the Fed’s holistic review. He looked at the role of the bank capital requirements during the pandemic and asked about the economic impact of raising these requirements. Barr clarified that the Fed is looking at requirements in the long-term and was not thinking about the particular moment right now. In general, he said that strong capital requirements allow banks to lend in good and bad times. Steil asked what the impact would be in the short-term analysis when raising bank capital requirements. Barr replied that any proposal would require public comment, analyzing that comment, putting in place a final rule, and an implementation period, which would ensure that there could not be a short-term impact. Steil asked if the short-term impact is negative in a macroeconomic sense. Barr said that there is not a yes or no answer to the question, it depends on how the changes are implemented and how banks respond. Steil had concerns about this but would look at the feedback to the holistic review. He turned to Gruenberg on fintech and asked him to elaborate on how the FDIC is streamlining compliance for fintech companies. Gruenberg replied that the FDIC has institutions that partner with fintechs to provide banking services and said that it is important for the institution to understand that with third party partnerships, it is as if the bank is directly providing those services.

**Rep. San Nicolas (D-Guam)** discussed inflation, saying that as the public deals with inflationary pressures and high interest rates, there is a very high likelihood that the increase in 30-day delinquencies is going to pick up. He asked if the Fed is monitoring this and if they consider it when they weigh interest rate policy. Barr replied that the Fed does track these delinquencies. San Nicolas asked others if they were seeing an uptick in credit and 30-day delinquencies. Gruenberg reported that the FDIC did see an uptick in 30–90-day delinquencies. Harper replied that there is a lagging correlation between unemployment and delinquencies, adding that the NCUA is working on guidance related to commercial real estate and evaluating that to provide financial institutions with greater clarity about what their regulatory expectations will be moving forward. Hsu said that the aggregate view on credit looks modest but said that there is some deterioration in certain segments.

**Rep. Norman (R-SC)** predicted that delinquencies will be going up and discussed access to capital through MDIs with Gruenberg. Norman then discussed appraisal discrimination and asked what the appraisers should do to fix that. Harper discussed the training program for appraisers and referred to an FHA study that found strong language that should not be brought to bear in certain communities when considering a comparable value.

**Rep. Gottheimer (D-NJ)** believed that digital asset innovation should have guardrails, but it also has great potential in our financial system. He referred to his legislation that would establish definitions and requirements for stablecoin issuers and would create a pathway for banks and nonbanks to become stablecoin issuers. Gottheimer asked how the Fed would create a supervisory framework that provides a level playing field for bank and nonbank issuers. Barr replied that because stablecoins are a form of private money, any legislation in this space should give the Fed oversight and regulatory authority. He thought if that is met, then the Fed can supervise institutions by treating like-risk in a similar way and ensure that stablecoins have prudential oversight and consumer protections in place. Gottheimer believed that Congress should establish guardrails for stablecoin issuers. He then shifted to Gruenberg on how an insurance product for stablecoin issuer deposits is something he has considered. He asked if stablecoin issuers are required to regularly prove that they are fully backed by cash or cash equivalents, does that eliminate the utility of creating insurance products for stablecoin deposits. Gruenberg replied that this is an important question and something to consider and emphasized that there is a need for prudential regulation and deposit insurance may be a separate question.

**Rep. Timmons (R-SC)** discussed CBDC and asked if Barr sees a need for one. Barr replied that it is important for the Fed to do the proper research to consider a CBDC so if it makes sense to go forward, the Fed is prepared. Timmons continued that Republicans have said that the Fed does not have authority to create a CBDC without congressional and executive approval and asked what approval means to him. Barr was unsure and said that ideally this would be through congressional legislation. He added that in the meanwhile, the Fed is focused on understanding the analysis of potential use cases and pilot scenarios. Timmons discussed real time payments networks and asked how this innovation provides similar benefits to a Fed issued CBDC. Barr replied that it is important for the Fed to get the basic payment rails out and when FedNow is rolled out, he thought that it would provide a lot of improvements to the payments system. He saw CBDC and FedNow swimming in their own lanes.

**Rep. Casten (D-IL)** discussed the moral obligation to Americans regarding climate and thanked the regulators for their roles on FSOC. He referred to a CFTC report that observed that private banks were offloading their mortgage risk to Fannie and Freddie in coastal areas and asked if the Fed has the tools to monitor how capital flows are moving from the big players to the smaller players and ensure that the scenario analysis of this is occurring. Barr replied that we are at an early stage in understanding how climate change flows through to financial risk and how it is distributed in the financial system and their effort to create climate guidance for large banks is new. Casten continued that as Americans are asking for more subsidies for fossil fuels, we are seeing states pass laws that prohibit banks from investing in clean energy, and asked Barr if he agrees that ignoring climate risk puts retirees at risk and if this is a breach of their fiduciary duty. Barr thought that it is important that financial institutions serve their customers with safety and soundness but that the Fed does not get involved in who or whom not to lend to.

**Rep. Loudermilk (R-GA)** discussed CRA ratings and asked about the bar being raised for CRA performance and questioned how the FDIC arrived at these thresholds. Gruenberg replied that he is referring to a joint proposal for rulemaking and explained that the proposal was looking at ratings for CRA lending and the objective was to expand access and see where more could be done. He added that the proposal is sensitive to expanding access and the capabilities of institutions. Loudermilk worried about disincentivizing banks if the bar is raised too high and said that the implementation period seems to be short, especially given the complexity of the rule, and thought the period should be longer than a year for banks to understand. He asked if there is any consideration for a longer compliance period. Gruenberg received comment on this and would give consideration to it in the final rulemaking.

**Rep. Pressley (D-MA)** believed that the CFPB is the only agency truly for consumers and worried about the litigation taking place around the CFPB. She asked if the mortgage market could constrict and provide fewer loans and wondered what would happen if the CFPB’s regulations were eliminated. Gruenberg thought that if the functions of the CFPB were undermined, then there would be consequences. She added that to the extent CFPB provides consumer protections, there will be consequences to the borrowers. Pressley turned to CRA reform and asked if the proposed rule should implicitly include communities of color in the banks’ assessment areas. Barr believed that the current proposal strikes a good balance on this question and said that banks cannot exclude communities of color and said that the areas of assessment are drawn broadly so they cannot be excluded under the rule. He thought that this would ensure that banks are not engaging in activity that would exclude people of color. Pressley emphasized the importance of modernizing the CRA.