STATEMENT OF

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on

OVERSIGHT OF FINANCIAL REGULATORS

before the

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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. As we quickly approach my first anniversary as Chairman, I appreciate the opportunity to share with the Committee how the Federal Deposit Insurance Corporation (FDIC) is working to ensure our regulated institutions are serving their communities and how our regulatory and supervisory efforts are strengthening the agency's oversight of depository institutions of all sizes.

The Financial Needs of Communities

Our nation's banks are the center of economic activity in their communities. The ability of these banks to provide safe and secure financial products and services to their customers forms the backbone of a strong national economy. The FDIC's oversight of these banks is critical to financial stability and consumer protection. It is incumbent that we exercise this oversight in a manner that recognizes an institution's business model and does not impose unnecessary costs or burdens on legitimate activities.

For these reasons, I have focused much of my efforts at the FDIC on understanding the needs of our communities and the banks that serve them. Our Community Bank Advisory Committee (CBAC), composed of bankers from across the nation, has been a valuable resource in this regard. By the end of the summer, I will also be nearly halfway through my 50-state listening tour. These meetings with local bankers, state supervisors, consumer groups, and our FDIC employees have been incredibly informative, and have underscored how important it is to get perspectives on our regulatory efforts outside the D.C. "beltway."

Based on the feedback from our banks and the communities they serve, I have challenged the FDIC to increase our efforts to:

- Promote and preserve the nation’s Minority Depository Institutions (MDIs);
- Encourage community banking, including the establishment of *de novo* banks in communities of all sizes;
- Provide clarity and consistency to financial institutions on their obligations under the Community Reinvestment Act (CRA); and
- Ensure that banks can help low- and moderate-income households – who are often unbanked or underbanked – meet their financial needs safely when confronted with a crisis.

Minority Depository Institutions

Many of the institutions overseen by the FDIC are small banks, including MDIs, whose communities have unique needs for accessing financial services, and our oversight must reflect their critical role in our financial system. The FDIC embraces its statutory responsibility to preserve and promote the health of MDIs. The vitality of these banks is critical given their role in the economic well-being of the minority and traditionally underserved communities many MDIs serve.

The FDIC has a number of initiatives underway to support MDIs:

- In 2018, we appointed a full-time, permanent executive to manage our MDI programs across the FDIC, and have increased the representation of MDIs on the CBAC from one to three institutions, where MDIs now represent one-sixth of CBAC members.

- In June of this year, we will host the first of several roundtables between MDIs and other FDIC-supervised institutions to share expertise and to promote possible collaborative opportunities, including direct investments and deposits in MDIs.
- In June, the FDIC will publish a research study on MDIs and host the 2019 Interagency MDI and Community Development Financial Institution (CDFI) Bank Conference.
- We continue to provide technical assistance to groups seeking to organize new MDIs, and to existing MDIs to support their efforts to acquire failing institutions (including three regional roundtables and two webinars over the last few months, an additional webinar in the future, and a workshop at our June MDI and CDFI conference).
- This fall, we will establish a new MDI subcommittee on the CBAC to both highlight the MDIs' efforts in their communities and to provide a platform for MDIs to exchange best practices.

Beyond these outreach efforts, the FDIC is working on a revised policy statement to underscore our commitment to the health of MDIs. We will continue other technical assistance efforts with these banks, including with groups seeking to create new MDIs.

Streamlining the De Novo Application Process

Banks – particularly community banks – are the economic heartbeat of communities of all sizes across the United States. New financial institutions preserve the vitality of the banking sector, fill important gaps in banking markets, and provide credit services to markets that may be overlooked. The FDIC is open to, and supportive of, deposit insurance filings from all firms, including fintechs. All applications for deposit insurance must be evaluated under the statutory requirements enumerated in Section 6 of the Federal Deposit Insurance Act (FDI Act).

While very few new banks opened in the years following the crisis, the FDIC is seeing renewed interest from organizers. To support the formation of these new institutions, the FDIC is reviewing its processes related to deposit insurance applications. For example, we have revised how we receive and review draft deposit insurance proposals. Under our new procedures, we now provide initial feedback to organizers on draft applications prior to formal submission, which helps them develop more actionable applications. To solicit additional ideas for improvement, we also conducted significant outreach efforts to engage the public, including issuing a Request for Information (RFI) last fall and holding seven roundtable events across the country.

CRA

Last year, the Office of the Comptroller of the Currency (OCC) solicited public feedback on how CRA regulations could be modernized to improve the effectiveness of the law and provide much needed clarity to financial institutions on compliance. The OCC, FDIC, and the Federal Reserve Board (FRB) have reviewed the comment letters received by the OCC and are working together on a proposal for a revised regulatory framework that can help meet these dual goals.

As these efforts proceed, our focus should include: clarifying what activities qualify for CRA consideration; reviewing how we assess lending – including digital lending – by banks outside of their main offices and branches; and ensuring that CRA investments target those most in need in a bank's community.

Small-Dollar Lending

According to a recent study by the FRB, nearly four in 10 households cannot cover a $400 emergency expense with cash.[1] While some banks offer small-dollar lending to help those in need, many banks have chosen not to offer such products because of regulatory uncertainty.[2] As a result, many families rely on non-bank providers to cover these emergency expenses, or their needs go unmet.

To solicit feedback on these products and consumer needs, the FDIC issued an RFI last year to learn more about small-dollar credit needs and concerns. We have reviewed the more than 60 comments received and plan to revisit our 2013 guidance to ensure that it does not impose an impediment to banks considering the extension of responsible small-dollar credit.

Appraisal Thresholds

Last year, the FDIC and our partner agencies finalized a proposal to raise the appraisal threshold for federally related commercial real estate transactions from $250,000 – where it was set in 1994 – to $500,000. Additionally, the agencies proposed raising the threshold for federally related residential real estate transactions from $250,000 – also set in 1994 – to $400,000. These

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[1] *Federal Reserve Board Report on the Economic Well-Being of U.S. Households in 2017* (May 2018), available at: https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf.

[2] The three prudential banking agencies have each taken a separate approach to small-dollar lending at the institutions they regulate. See FDIC FIL-50-2007, *Affordable Small-Dollar Loan Guidelines* (June 19, 2007), available at: https://www.fdic.gov/news/news/financial/2007/fil07050.pdf; OCC Bulletin 2018-14, *Core Lending Principles for Short-Term, Small-Dollar, Installment Lending* (May 23, 2018), available at: https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html; *Federal Reserve Statement on Deposit Advance Products* (April 25, 2013), available at: https://www.federalreserve.gov/supervisionreg/caletters/caltr1307.htm.

Additionally, the Consumer Financial Protection Bureau has promulgated a rule that is now being revisited. See *CFPB Notice of Proposed Rulemaking to Delay the August 19, 2019 Compliance Date for the Mandatory Underwriting Provisions of the 2017 Final Rule to November 19, 2020* (February 6, 2019), available at: https://files.consumerfinance.gov/f/documents/cfpb_payday_nprm-2019-delay.pdf; and *CFPB Notice of Proposed Rulemaking to Rescind Certain Provisions of its 2017 Final Rule Governing Payday, Vehicle Title, and Certain High-Cost Installment Loans* (February 6, 2019), available at: https://files.consumerfinance.gov/f/documents/cfpb_payday_nprm-2019-reconsideration.pdf.

proposed changes balance current market realities and price appreciation, including needs in rural communities where access to appraisal services can be limited, with the need to ensure the safety and soundness of our institutions. We have received numerous comments on these proposals and are currently working to finalize the rulemaking.

Regulatory Efforts to Strengthen the Financial System

The FDIC strives to implement its regulatory approach to Insured Depository Institutions (IDIs) in a manner that reflects differences in risk profile among industry participants, while achieving our goals for a safe, sound, and stable banking system. To support our regulatory efforts, FDIC examiners conduct bank examinations using a risk-focused examination program, which helps the FDIC identify emerging risks and take supervisory or regulatory actions to help mitigate those risks. Our ability to effectively supervise larger institutions is a particularly critical foundation for our regulatory efforts and to ensure that large and complex financial institutions are resolvable in an orderly manner.

The FDIC is the primary federal regulator for 3,495 state-chartered institutions that are not members of the Federal Reserve System.[3] Of this number, 40 have assets above $10 billion. We have adopted a comprehensive and uniform supervisory process for oversight of these larger institutions. For institutions where the FDIC is the primary regulator, we generally apply a continuous examination program with dedicated staff conducting ongoing, on-site supervisory examinations and off-site institution monitoring. Staff works closely with other regulators to identify emerging risks across the agencies' portfolio of large institutions, assess the overall risk profile of the institutions, and promote consistency in supervisory approach.

[3] As of December 31, 2018.

The FDIC's Large Insured Depository Institution (LIDI) Program remains a primary tool for off-site monitoring of large IDIs, with the exception of the most complex IDIs. The LIDI Program provides a comprehensive process to standardize data capture and reporting for large institutions nationwide, allowing for quantitative and qualitative risk analysis. The LIDI Program supports effective large bank supervision by using individual institution information to focus resources on higher risk areas, determine the need for supervisory action, and support insurance assessments and resolution planning.

The FDIC regularly monitors the potential risks at all IDIs, including those for which it is not the primary federal supervisor. Through close coordination and collaboration with the OCC, FRB, and various state bank regulators, the FDIC monitors all institutions to ensure the Deposit Insurance Fund (DIF) is not placed at risk, and when necessary, exercises the authority to conduct special (backup) examination activities of IDI's where the FDIC is not the primary regulator.

For the most complex firms (the Global Systemically Important Banks, or G-SIBs), the FDIC has also established a Systemically Important Financial Institution (SIFI) Risk Report that is used to identify key vulnerabilities and assess capital sufficiency.

Appropriately Tailoring Regulatory Efforts

Given the difference in size and complexity at our nation's financial institutions and the continued evolution of the financial services industry and our economy as a whole, it is vital that the FDIC continuously evaluate the regulatory framework for IDIs.

Congress directed specific action with respect to regulatory tailoring in the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Beyond EGRRCPA, the FDIC has a responsibility to regularly revisit prior regulations and guidance to ensure that we are appropriately addressing new risks to the system and are not imposing unnecessary regulatory burdens that might impede safe and secure banking activities. In addition, under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), the FDIC has a responsibility to review our regulations at least once every 10 years to identify any outdated, unnecessary, or unduly burdensome requirements. To meet the congressional mandates of EGRRCPA and EGRPRA and our general regulatory responsibilities, the FDIC has taken numerous actions over the past year to appropriately tailor our regulatory approach to the risk presented by the individual institutions we oversee, while maintaining requisite safety and soundness and consumer protection.

EGRRCPA

Consistent with the statutory mandates in EGRRCPA, the FDIC has undertaken targeted changes to simplify the regulatory regime for community banks and small and mid-size regional banks based on their risk profiles, while maintaining the most robust capital and liquidity standards for our nation's largest, most systemically important banks. The FDIC has made considerable progress in implementing the requirements of EGRRCPA. For example, the FDIC has issued:

- An interagency proposal to incorporate exemptions from appraisal requirements for certain rural transactions (Section 103);
- A final rule to except a limited amount of reciprocal brokered deposits from being reported in Reports of Condition (Section 202);
- An interagency proposal to allow reduced reporting requirements in the first and third calendar quarters for certain institutions (Section 205);

- An interagency interim final rule to treat certain municipal obligations as high-quality liquid assets for purposes of calculating the liquidity coverage ratio (Section 403);
- Two interagency proposals to tailor capital and liquidity requirements according to risk-based categories, one for domestic and one for foreign banking organizations with total consolidated assets of $100 billion (Section 401);
- An interagency proposal to amend the supplemental leverage ratio for custodial banking organizations (Section 402); and
- An interagency proposal to revise the definition of a high-volatility commercial real estate exposure (Section 214).

Volcker Rule

Having observed several years of Volcker Rule compliance by FDIC-regulated entities, it has become clear that the rule as originally constructed is extremely complex and too subjective, resulting in uncertainty and unnecessary burden for smaller, less complex institutions.

To address some of these concerns, Congress exempted from the Volcker Rule all banks below $10 billion in consolidated assets that do not engage in significant trading activity. The five agencies[4] responsible for implementing the Volcker Rule have issued a notice of proposed rulemaking to fulfill the requirements of Section 203, which we expect to finalize soon.

Notwithstanding the proposed changes in EGRRCPA, the five agencies issued a separate, additional proposal, broadly referred to as Volcker 2.0. This proposal sought to simplify the rule and reduce the amount of subjectivity in its implementation. Benefitting from a review of 151 comment letters, we are working with our partner agencies toward revisions to the Volcker Rule to provide more clarity, certainty, and objectivity to market participants.

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[4] The agencies responsible for implementation of the Volcker Rule include the FDIC, OCC, FRB, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

Brokered Deposits Advance Notice of Proposed Rulemaking

The FDIC is undertaking a comprehensive review of our long-standing 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 December 2018, our Board approved an Advance Notice of Proposed Rulemaking (ANPR) to seek public comment on all aspects of the FDIC's brokered deposit and interest rate regulations with a comment period that closed on May 7. In particular, we have heard concerns about the current methodology for calculating national rate caps applicable to less than well capitalized banks, and we appreciate the urgency surrounding this issue. The FDIC is expediting the rate cap component of our review with the goal of issuing a proposal for comment and a final rule by the end of the year.

Community Bank Leverage Ratio

Efforts to comply with Basel III capital standards have imposed substantial compliance costs on community banks. In fact, at the time of the U.S. Basel III rulemakings, the FDIC, OCC, and FRB found that the vast majority of community banks already maintained sufficient capital levels to exceed the new minimum thresholds.[5] The Basel III standards, which were intended for internationally active banks, are simply too complex and ultimately unnecessary for community banks.

[5] See OCC and the FRB Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 FR 198 (October 11, 2013).

In September 2017, the FDIC took an initial step to streamline the capital regime for small banks by issuing the proposed "capital simplification rule" under EGRPRA.[6] This proposed rule would modify the treatment of mortgage servicing assets, certain deferred tax assets, and investments in unconsolidated financial institutions, such as Trust Preferred Securities (TruPS), among other provisions. The FDIC will finalize this capital simplification proposal in the next few weeks.

In the meantime, Section 201 of EGRRCPA directed the FDIC to provide an optional community bank leverage ratio (CBLR) for qualifying community banks. The FDIC, OCC, and FRB issued a proposal to implement the CBLR in November 2018.[7]

Under the proposed CBLR rule, a qualifying bank with less than $10 billion in consolidated assets would not have to comply with the existing risk-based capital requirements if the bank meets a simple ratio of tangible equity to total assets. The proposal includes a definition of tangible equity that is designed to be very simple to calculate and includes high-quality, loss-absorbing capital. In order to qualify under the proposal, banks will need to satisfy certain activity-related criteria and calculate a simple leverage ratio. This approach is most appropriate for small banks with traditional business models. Another key feature of the CBLR proposal is that it is optional.

We estimate that over 80 percent of community banks would be eligible for the proposed CBLR based on the proposed calibration and qualifying criteria. This was a key priority in

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[6] See FDIC Notice of Proposed Rulemaking *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, FIL-45-2017 (September 27, 2017), available at: https://www.fdic.gov/news/news/financial/2017/fil17045.pdf.
[7] See OCC, FRB, and the FDIC Notice of Proposed Rulemaking, *Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations*, 84 FR 3062 (February 8, 2019), available at: https://www.fdic.gov/news/board/2018/2018-11-20-notice-sum-b-fr.pdf.

designing the proposal – to ensure that the simple ratio would be available broadly and without too many complex restrictions.

A key burden reducing aspect of the proposal is that the CBLR would require a single page of regulatory reporting, a substantial reduction from the 15 pages currently required.

Since the agencies issued the CBLR proposal, we received numerous helpful comments and are carefully reviewing each of them. For example, we have heard feedback on the CBLR levels proposed as proxies under the Prompt Corrective Action (PCA) framework. These proxies were included in the proposal as an option for institutions that fall below the CBLR to allow them to continue to use the framework. Reverting to Basel III based capital calculations at a time when they should be focused on addressing their declining capital position could be resource intensive and counterproductive for a small bank. We recognize that this has caused some concern and are considering how best to proceed with this feature of the proposal based upon the comments.

Stress Tests

Section 401(a) of EGRRCPA raised the minimum consolidated asset threshold for financial company-run stress tests from $10 billion to $250 billion. In July 2018, the FDIC, OCC, and FRB gave immediate relief from these requirements to banking organizations with less than $100 billion in assets. We expect to finalize the proposed rules to implement these statutory changes in the coming months.

The agencies are also considering amendments to the 2012 Stress Testing Guidance that would provide for further tailoring of supervisory expectations. In particular, the agencies are considering raising the asset threshold in the 2012 Stress Testing Guidance to $100 billion. Under such an approach, banking organizations under $100 billion in assets would be expected to use appropriate risk management processes to address risks in specific subject matter areas rather than undertake a general, comprehensive stress testing framework more appropriate for larger firms.

Resolution Planning

The FDIC is tasked with resolving failed banks and, if called upon, large bank holding companies or other SIFIs. To support this mandate and improve their resolvability, the largest bank holding companies are required by law to submit resolution plans outlining how they can fail in an orderly way under the Bankruptcy Code.

Since the resolution planning requirements took effect in 2012, large firms have improved their resolution strategies and governance, refined their estimates of liquidity and capital needs in resolution, and simplified their legal structures. For example, the U.S. G-SIBs have developed a single-point-of-entry (SPOE) resolution strategy that is intended to enable the functioning of critical operations at key subsidiaries, while the parent enters a preplanned bankruptcy proceeding designed to facilitate the recapitalization of key subsidiaries, preserve going concern value, and protect financial stability. These firms have also established clean holding companies and issued long-term debt which can be converted to equity in the event of a failure. These actions help ensure that market participants — not taxpayers — bear the risk of loss.

In addition to the bankruptcy planning requirements for the largest U.S. bank holding companies, the FDIC also reviews resolution plans filed by larger IDIs planning for resolution under the FDI Act (IDI Rule). This work, along with other measures, has improved our readiness for these resolutions.

Based on experience implementing both rules, the FDIC issued two proposals in April to build on progress already made and to make the resolution process more efficient and effective. The proposals reflect my views that resolution planning for the largest institutions is critical, and we can make improvements to the process.

First, the FRB and the FDIC published for public comment a proposal that would modify resolution plan requirements for large bank holding companies. This proposal implements changes to resolution planning requirements under EGRRCPA, and proposes exempting smaller regional banks from the rule. The proposal also seeks to codify a reduction in frequency of submissions, reflecting the current two-year filing schedule for the largest domestic bank holding companies, and proposes a three-year filing schedule for other filers. The proposal would also allow firms to submit targeted plans focused on the most material topics identified by the FDIC and FRB, including capital, liquidity, and material changes that have occurred in between full submissions. Still, plans submitted would remain subject to rigorous review by both agencies.

Second, the FDIC published for public comment an ANPR that seeks comment on potential changes to the IDI Rule. Among other issues, the agency is considering whether to revise the threshold for application of the rule and to tier the rule's requirements based on the size, complexity, or other characteristics of an IDI. The agency is also seeking feedback on ways to streamline plan submissions for larger, more complex firms and on whether to replace plan submissions with periodic engagement and capabilities testing for smaller, less complex firms that are subject to the rule.

The Role of Guidance

As a supervisor, our rules and expectations should be clear to those we supervise. A key aspect of effective supervision is providing a level of certainty surrounding compliance with applicable laws and regulations.

Related to this concept, much has been said about the role of guidance in our regulatory and supervisory framework. Under the Administrative Procedures Act, a rule is defined, in part, as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[8]

Separately, there is supervisory guidance. Supervisory guidance can be a helpful tool to provide clarity to our regulated institutions and to FDIC supervisory staff on how to operate in a safe and sound manner, be fair to consumers, and comply with applicable laws and regulations. But supervisory guidance documents are *not* the same as rules, and should not be treated as such.

In September, the FDIC joined several other agencies to issue a statement clarifying to examiners and financial institutions that institutions cannot be criticized for "violations" of guidance, only for violations of law, regulation, or other enforceable conditions. We have taken a number of steps to ensure our examiners understand this, including written instructions, all-hands examiner calls, and in-person training. We also are reviewing our outstanding guidance documents, the role such guidance documents play in the examination process, and our approach to issuing supervisory guidance going forward, including compliance with the Congressional Review Act.

[8] 5 U.S.C. §551(4).

Supervisory Efforts to Ensure Safety, Soundness, and Consumer Protection

As noted, the FDIC is the primary federal regulator for 3,495 institutions.[9] The FDIC also has backup supervisory responsibilities under the FDI Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[10] These supervisory activities (whether as a primary regulator or in conjunction with our partner agencies) are critical to fulfilling our statutory mandate to protect the DIF and to ensure the stability of, and public confidence in, the nation's financial system.

Supported by our supervision efforts and a strong economy, our nation's banks are stronger than ever. Over the last ten years, we have replenished the DIF to $102.6 billion,[11] representing a ratio of 1.36 percent compared to industry estimates of insured deposits. No institutions failed in 2018, and none have failed thus far in 2019. The FDIC also decreased the number of receiverships under management by 66 last year, and has terminated an additional nine receiverships this year, leaving 263 receiverships under management at this time.

Our efforts to investigate bank failures and identify possible violations of law and regulation help hold banks accountable, as well as their officers, directors, and other employees or contractors. During 2018 alone, the FDIC recovered $116.3 million from professional liability claims and settlements. Recently, the FDIC concluded a historic $335 million settlement, tying a record for the largest settlement ever by any plaintiff in an accounting malpractice case.[12] Working with the Department of Justice, the FDIC also helped collect $8.3 million in criminal restitution and forfeiture orders in 2018.

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[9] As of December 31, 2018.
[10] 12 USC Sections 1820(b)(3) and 1818(t).
[11] As of December 31, 2018.
[12] The aggregate amount of the settlement was $395 million, when the additional $60 million settlement against another party in the action is counted. FDIC Press Release, *FDIC Settles with PricewaterhouseCoopers LLP on Audits of a Failed Bank*, PR-19-2019 (March 15, 2019). Available at: https://www.fdic.gov/news/news/press/2019/pr19019.html.

The FDIC also initiates enforcement actions based on unsafe and unsound practices or conditions in institutions, violations of law and final agreements, and breaches of fiduciary duty, dishonesty or willful disregard by institution-affiliated parties. In that regard, the FDIC initiated 100 formal enforcement actions in the last year, which included 23 cease-and-desist actions, 52 actions to remove individuals from the banking industry, and 25 civil money penalties for illegal conduct. More than $20 million was provided in restitution to consumers affected by improper practices during the year. Taken together, these supervisory and enforcement actions help protect our financial system and the customers that rely on financial institutions for safe and secure products and services.

Risk Monitoring

Our supervision efforts also help to identify and mitigate risks to the financial system, working both independently and in partnership with our fellow regulators. The FDIC is an active participant in the Financial Stability Oversight Council (FSOC), working with other regulators to monitor activities and events that could pose risks to the financial system. These coordinated efforts help to identify emerging risks to the financial system and are particularly salient in two areas, leveraged lending and cyber threats.

Leveraged Lending

With respect to direct exposure to leveraged loans, banks generally hold the revolving portion of leveraged transactions, which tends to be less risky than the portion held by institutional investors. Nonetheless, risks could flow back into banks through pipeline risk, indirect exposure through financing to non-bank lenders, and investment in collateralized loan obligations (CLOs). In addition, a significant rise in leveraged loan defaults could have broader economic impacts that affect both bank and non-bank sponsors of leveraged loans, and is something the FDIC is carefully monitoring.

Moreover, the FDIC continues to monitor the risks posed by leveraged lending, including developments in the market, growth in leveraged lending, concentrations of exposure at financial institutions, and associated underwriting standards. We are engaged in a continuous dialogue with other regulatory agencies on this matter.

Cyber Threats

The FDIC is also actively monitoring cybersecurity risks in the banking industry. FDIC examiners conduct examinations to ensure that financial institutions are appropriately managing their exposure to cybersecurity risk. Our examiners verify that bank management has considered how cyber events could disrupt their operations and has designed resilience into their operations. To support banks in this regard, we recently added two new scenarios to a tool available on our website named "Cyber Challenge." Cyber Challenge is a set of ready-to-use scenarios and questions to assist banks as they discuss operational risk and the potential impact of information technology disruptions on banking functions. Notwithstanding these efforts, the risks posed by cyber threats remain persistent, and the fight against these threats will require continued joint efforts by the public and private sectors.

Transparency

The FDIC's responsibilities to preserve and promote confidence in the financial system and to protect the DIF also require openness and accountability to the public and insured institutions. To support these principles, we launched the FDIC's "Trust through Transparency" initiative in 2018 and created a new section on the FDIC's public website where we publish FDIC performance metrics.[13]

The site also contains guidelines and decisions related to appeals of material supervisory determinations and deposit insurance assessments, as well as policies and procedures for how we conduct our work. Additionally, we made publicly available information on how our case managers and examiners implement the risk-focused supervision program. The FDIC is further reviewing our processes to ensure we have the proper balance between protecting confidential information and providing public access, and we will add to this website over time.

BSA/AML Compliance

Bank Secrecy Act and Anti-Money Laundering (BSA/AML) laws and regulations are a vital component of U.S. efforts to prevent unlawful financial transactions that help fund criminals, terrorists, and other illicit actors. These terrorists and criminals use increasingly sophisticated methods to conceal their transactions in an evolving financial, technological, and regulatory landscape.

The FDIC and the institutions we supervise for BSA/AML compliance recognize the importance of BSA/AML reporting. Nonetheless, the FDIC also recognizes that meeting these compliance obligations imposes billions of dollars in compliance costs at regulated institutions.

Considering these costs, we continue to encourage the Financial Crimes Enforcement Network (FinCEN) and our partners in law enforcement and the intelligence community to actively communicate the importance of this reporting and the impact that it has on their efforts

[13] *FDIC Transparency & Accountability* (October 04, 2018), available at: https://www.fdic.gov/transparency/.

to detect, deter, and disrupt criminal and terrorist organizations. At a recent CBAC meeting, FinCEN provided just such an eye-opening and unclassified briefing to CBAC members.[14]

In addition to these communication and outreach efforts, the FDIC, along with the other federal banking agencies and the Department of the Treasury, including FinCEN, have convened a working group to focus on initiatives to improve the efficiency and effectiveness of the BSA/AML regulatory regime. The working group has already released statements encouraging innovation in BSA/AML compliance and identifying areas where banks can share compliance resources.[15]

CAMELS Ratings

Since I arrived at the FDIC, I have sought to review longstanding processes and procedures that have not received regulatory scrutiny or updating in a decade or more to determine if they warrant modernization. One such supervisory tool is the interagency CAMELS ratings system that has been in place for more than 20 years and is vital to our supervisory efforts. Given its maturity and subsequent changes in the industry and technology, it is appropriate to ask for the public's views on the existing approach, how it has been implemented, whether it has been applied consistently to institutions of varying sizes, business models, complexity, and risk profiles, and the impact of various ratings on supervisory actions, including enforcement proceedings and application reviews. I have asked staff to develop options for working with other Federal Financial Institutions Examination Council (FFIEC) members to seek the public's input on this topic.

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[14] *FDIC Advisory Committee on Community Banking: Archived Videos/Webcast of Advisory Committee Meeting* (March 28, 2019), available at: http://fdic.windrosemedia.com/.
[15] FRB, FDIC, FinCEN, NCUA, and OCC *Interagency Statement on Sharing Bank Secrecy Act Resources*, FIL-55-2018 (October 3, 2018), available at: https://www.fdic.gov/news/news/financial/2018/fil18055.pdf.

Reducing Community Bank Examination Burden

The compliance officer at many of our community banks wears many hats, and may also be the Chief Financial Officer, a loan officer, and a teller. If we can make compliance at our nation's community banks less complex, while maintaining safety and soundness and consumer protections, we can help banks focus resources on the business of banking their communities, not dealing with bureaucracies. As an example, the FDIC was able to archive nearly 60 percent (493) of 837 pieces of supervisory guidance just by eliminating outdated and duplicative documents that had never been archived in more than two decades. We were able to take these steps without compromising the safety of the institutions or the stability of the financial system as a whole.

We have also incorporated additional risk-focusing and leveraged technology in our examinations to reduce the amount of time we are on-site at an institution without sacrificing the quality of our examinations. Risk-focusing allows our examiners to review information from an institution before an examination begins; to gain a better understanding of the institution's business model, complexity, and risk profile; and to focus resources during an exam on areas that present the most risk to the institution or its customers. Technology has allowed our examiners to perform some examination activities at the local field office instead of on-site at the institution, and we are focusing on additional opportunities to take advantage of technology in the examination process.

In 2018, risk-focusing and leveraging technology for consumer compliance exams allowed the FDIC to conduct an average of 62 percent of our examination off-site. We have incorporated similar risk-focusing and technology in our prudential exams, and have cut on-site days from 27 in 2010 to 23 in 2018. As we train our examiners more on the use of these techniques and incorporate new technology, we will further cut the costs of our exams on institutions without compromising on quality.

Leveraging Technology

The FDIC supports innovation in the financial services industry, with particular focus on community banks. To ensure that we are prepared to address the changing landscape in financial services, the FDIC has dedicated significant resources to identify and understand emerging technologies. In October 2018, I announced that the FDIC would be launching an office of innovation, which we have since named the FDIC Tech Lab, or FDiTech for short.

While some banks have spent substantial sums on new technology and others have partnered with fintechs to expand their products and services, many banks – especially smaller banks – have been reluctant or simply unable to invest. We have already engaged with banks to understand how they are innovating and to promote technological development at community banks with limited funding for research and development. We are also looking at policy changes that may be needed to encourage innovation, while maintaining safe and secure financial services and institutions. Rather than play “catch up” with technological advances, the FDIC’s goal is to stay on the forefront of changes through increased collaboration and partnership with the industry, to promote increased competition in the financial services sector, and to support innovation at community banks, including MDIs.

Modernizing the FDIC

As the financial services industry changes, the FDIC must evolve.

Over the last year, we have made significant investments in new technology within the FDIC. Our Chief Information Officer has initiated a data management initiative that will promote information sharing within the FDIC and will enable the application of advanced analytic tools to FDIC data sets, including machine learning and artificial intelligence.

We have also established a Supervision Modernization Subcommittee for the CBAC. This subcommittee – composed of banks, technologists, legal experts, former regulators, and distance learning leaders – will make recommendations to the CBAC for improving our supervision activities. These recommendations will support new investments in technology and improvements in our supervision processes, including how we hire, train, and deploy our workforce.

Maintaining a Diverse Workforce

As I explained to the FDIC workforce in my inaugural equal employment opportunity policy statement, my personal and professional experiences have highlighted the importance of a workplace that is free from discrimination and that supports diversity and inclusion. The FDIC has a long-standing commitment to diversity. The racial, ethnic, and gender diversity of the FDIC workforce continues a steady increase since 2010 with minority representation at 29.9 percent and with women comprising 44.9 percent of permanent employees. We have continued our efforts to promote the participation of Minority and Women-Owned Businesses in FDIC contracting actions. We will continue to cultivate an FDIC that is accessible, inclusive, and diverse, treating everyone with dignity and respect while embracing our differences.

Conclusion

Most of my professional life has been focused on the financial services industry. Before my tenure at the FDIC, I intuitively understood how important our nation's banks were to the economy. But until I had real conversations with bankers, their customers, and state supervisors on my 50-state listening tour, I did not fully appreciate how our banks – particularly community banks – are so intimately involved in the fabric of their communities and customers' lives. Across the country, these banks help fund a town's grocery stores, barber shops, restaurants, local libraries, and small businesses. In rural communities and urban settings, our banks provide a critical lifeline for low- and moderate-income customers, while supplementing infrastructure and social services.

The FDIC's role is to provide the confidence needed for customers to trust those banks with their deposits. Every day, I am proud to join my colleagues at the FDIC in fulfilling our mission to preserve and promote public confidence in the U.S. financial system. And I would be remiss if I did not mention the 6,000 dedicated FDIC employees who go to work every morning laser-focused on protecting the stability and integrity or our financial system. To them, I am most grateful for their warm welcome and for being open to the accountability, transparency, and collegiality that make me proud to run such an exceptional agency.

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