Supervision and Regulation Report

April 2021

Board of Governors of the Federal Reserve System

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Corrections

The Federal Reserve revised this report on July 6, 2021, to reflect corrected data, including adjustments to revised regulatory filings. The revision is listed below.

On page 25, in the Supervisory Developments section, the data for table 2, "Supervised Institutions (data as of 2020:Q4)," were corrected for the number of large and foreign banking organizations from 175 to 174 and total assets (trillions of dollars) from $8.8 to $9.1. The total number of small FBOs (rep offices) was changed from 32 to 30. The total number of state member banks was changed from eight to nine and total assets (trillions of dollars) from $1.1 to $1.2.

Contents

Preface

The Federal Reserve Board publishes this semiannual report to inform the public about its efforts to promote safety and soundness in the banking system. It includes information about banking conditions and the Board's supervisory and regulatory policies and actions.

This issue of the report focuses on the Federal Reserve's regulatory and supervisory response to the economic and financial stresses created by the COVID event.[1]

For more information on how the Board promotes the safety and soundness of the banking system, visit the Supervision and Regulation section of our public website (https://www.federalreserve.gov/supervisionreg.htm).

[1] The Federal Reserve typically releases the report in conjunction with testimony before Congress by the Vice Chair for Supervision.

Summary

Over the past year, the COVID event presented remarkable challenges for households, businesses, and the economy.

The Federal Reserve and supervised institutions took swift action to respond to these unprecedented times. The Federal Reserve made temporary adjustments to its regulations and supervisory programs to help the banking industry meet the needs of customers and communities. Banking organizations played a critical role in supporting their customers and the broader economy. Among other actions, banking organizations have waived fees and restructured loans to ease financial burdens, continued to lend to households and businesses, and took steps to maintain safe and sound operations.

However, the economic recovery is not complete. As a result, the Federal Reserve continues to closely monitor banks' risk exposures, credit performance, and operations.

This report focuses on developments in three areas:

- Banking System Conditions provides an overview of current financial conditions in the banking sector. Overall, the banking system has demonstrated financial and operational resilience through the COVID event. The report describes measures of health of the system, as well as areas of focus given ongoing uncertainty.
- Regulatory Developments provides an overview of the Federal Reserve's recent regulatory policy work. The Board took a number of policy actions from April 2020 to April 15, 2021. Many of these supported the flow of credit to help underpin economic recovery.
- Supervisory Developments provides an overview of the Federal Reserve's supervisory programs, approaches, and actions in response to the COVID event and its effects on the banking and financial system. The report distinguishes between large financial institutions and community and regional banking organizations because supervisory approaches and priorities differ across these groups.

Banking System Conditions

This overview of banking system conditions is based on data collected by the Federal Reserve and other federal financial regulatory agencies, as well as market indicators of industry conditions.

The Banking System Has Demonstrated Financial and Operational Resilience

The benefits of a resilient banking system have been evident throughout the COVID event. Banks have been able to take in consumer savings, grant loan modification requests, and fund corporate borrowers via credit lines and bond issuance.

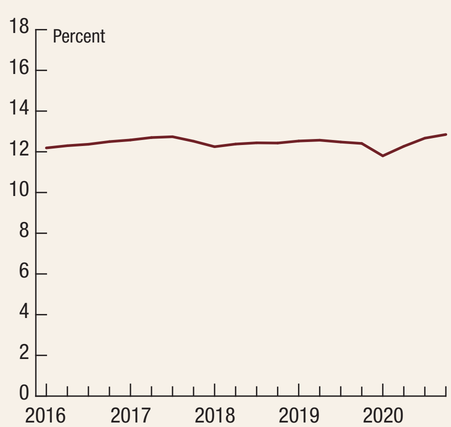
Capital and liquidity positions remain robust.

Financial institutions' strong capital and liquidity positions have enabled the banking system to support the recovery of the U.S. economy.

Banks entered the COVID event with strong capital positions and built further capital last year. For example, the aggregate common equity tier 1 (CET1) capital ratio exceeded its pre-COVID-event level in the second half of 2020 (figure 1). As of year-end 2020, capital ratios remain well above regulatory minimums at nearly all firms, providing a buffer to absorb losses and support lending as the economy recovers.

Bank liquidity also strengthened last year, thanks to strong growth in deposits. Higher deposits helped banks expand liquid assets (figure 2) and reduce wholesale funds. Bank deposit balances increased by over $3 trillion since year-end 2019. Many factors contributed to the rapid growth in deposits. These include higher levels of consumer savings, drawdowns of business loan commitments, Paycheck Protection Program (PPP) loan originations, investor preference

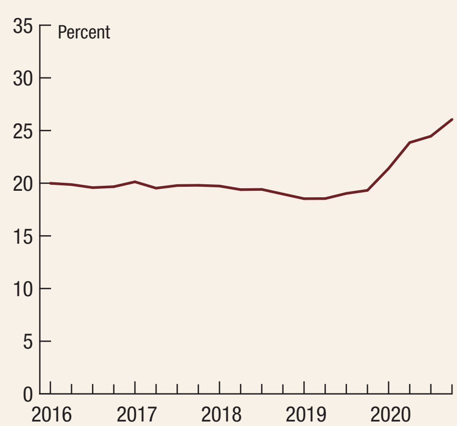
Figure 1. Aggregate common equity tier 1 (CET1) capital ratio



Note: CET1 capital ratio is the ratio of common equity tier 1 capital to risk-weighted assets. See the data appendix for further information.

Source: Call Report and FR Y-9C.

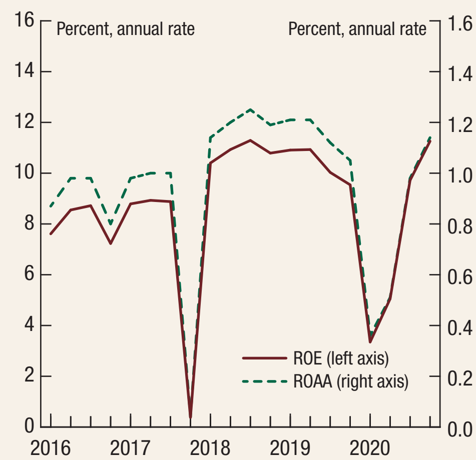
Figure 2. Liquid assets as a share of total assets



Note: Liquid assets are cash plus estimates of securities that qualify as high-quality liquid assets (HQLA) as defined by the liquidity coverage ratio requirement. See the data appendix for further information.

Source: FR Y-9C.

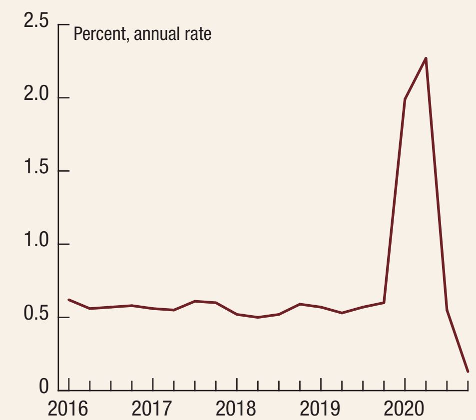
Figure 3. Bank profitability



Note: ROE is net income/average equity capital, and ROAA is net income/average assets.

Source: Call Report and FR Y-9C.

Figure 4. Provisions to average loans and leases



Source: Call Report and FR Y-9C.

for safe assets, record corporate bond issuance, fiscal stimulus payments, and expanded unemployment benefits.

Banks have taken actions to maintain their operational resilience.

Many banks had invested in technology to improve their capacity to process digital transactions prior to the COVID event. This investment enabled banks to continue to provide banking services and work with their customers in a remote environment. As discussed later in this report, cybersecurity risk has been amplified by the COVID event and remains an ongoing supervisory concern. Banks have focused on ensuring their controls are sufficient to mitigate increasing cyber risks.

Bank profitability has mostly rebounded to pre-COVID-event levels.

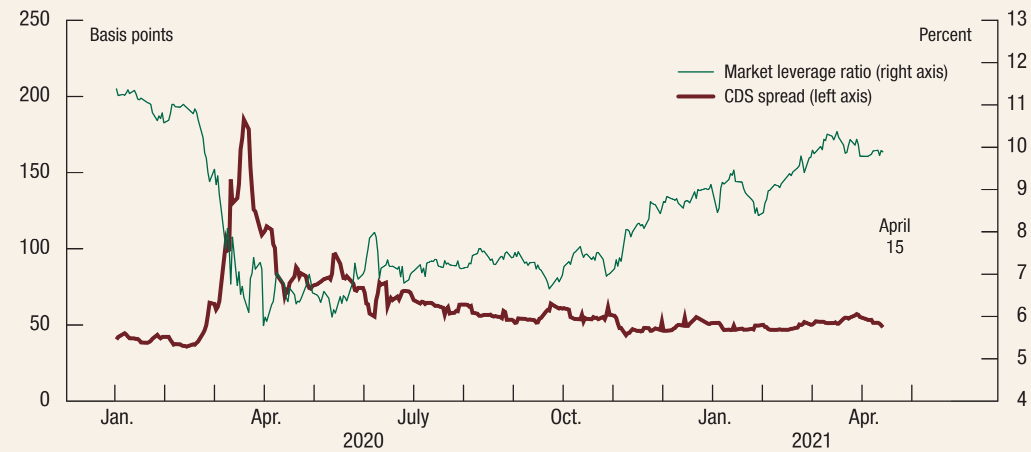
After falling sharply during the first half of 2020, bank profitability, as measured by return on equity (ROE) and return on average assets (ROAA), improved and reached pre-COVID-event levels by year-end 2020 (figure 3).[2] Smaller loan loss provisions accounted for most of the recovery, as discussed below. Improved trading, investment banking, and mortgage banking revenues also contributed to the rebound, offsetting a decline in net interest margins.

Loan loss provisions, which provide banks with a cushion to absorb losses on loans, often are an important driver for bank profitability.[3] Provisions rose sharply in the first quarter of 2020 as banks aggressively lowered their economic forecasts and anticipated more problem loans. As the economic outlook improved over the year and loans performed better than expected, banks reduced provisions (figure 4).

2 The dip in ROE and ROAA in the fourth quarter of 2017 was driven by a one-time tax effect associated with the Tax Cuts and Jobs Act of 2017.

3 See the data appendix for more detail.

Figure 5. Average credit default swap (CDS) spread and market leverage ratio (daily)



Note: The market leverage ratio is the ratio of a firm's market capitalization to the sum of market capitalization and the book value of liabilities. Averages are calculated from available observations for the eight LISCC firms (Bank of America Corporation; The Bank of New York Mellon Corporation; Citigroup Inc.; The Goldman Sachs Group; JPMorgan Chase & Co.; Morgan Stanley; State Street Corporation; and Wells Fargo & Company) .

Source: Bloomberg.

Key market indicators reflect improved conditions.

Market indicators of bank health, including market leverage ratios and credit default swap (CDS) spreads, experienced a sharp deterioration in the first quarter of 2020 (figure 5). The market leverage ratio is a market-based measure of a firm's capital level. A higher ratio generally indicates higher confidence in a bank's financial strength. The aggregate market leverage ratio dipped below 6 percent in April 2020. It stabilized through the third quarter of 2020 and improved to over 10 percent in March 2021.

CDS spreads are a measure of the market's perception of bank default risk. Smaller spreads indicate higher investor confidence in a bank's financial strength. After spiking in the first quarter of 2020, CDS spreads recovered in the second quarter of 2020. Since then, they have largely remained stable. Both indicators are currently near their pre-COVID-event levels, reflecting stabilization in the financial markets and increased confidence in the banking system.

Banks are playing a vital role in the PPP.

The Small Business Administration's (SBA) PPP provided small businesses with credit and liquidity support at a time when it was badly needed. Created under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and amended under the Consolidated Appropriations Act, 2021, the PPP provided forgivable loans to support payroll costs at small businesses and nonprofit organizations. PPP loans can be fully forgiven if the funds are used for payroll costs, mortgage interest, rent, or utilities.

The SBA initially processed PPP loans between April and August 2020. During this period, lenders made more than 5.2 million PPP loans, totaling $525 billion. The SBA began processing PPP loans again in January 2021. Between January and mid-April 2021, lenders made another 4.7 million PPP loans, totaling $240 billion.[4] Banks made the majority of PPP loans. Bank participation in the program was broad, as roughly 85 percent of banks made PPP loans. Recent legislation provided new borrowers with more flexibility and allowed some borrowers that already received a PPP loan to obtain a second loan. The new legislation also provided priority loan access for underserved borrowers and for community development financial institutions and minority depository institutions.

The Federal Reserve created the Paycheck Protection Program Liquidity Facility (PPPLF) to support PPP lending. The facility allows lenders to borrow funds from the Federal Reserve, using PPP loans as collateral. The Federal Reserve allows banks to exclude PPP loans pledged as collateral to the PPPLF from capital requirements. Additionally, PPP loans held by banks receive a zero percent risk weight under the regulatory capital rule.[5]

Areas of Focus Given Ongoing Uncertainties

Despite the overall health of the banking sector, some areas have shown signs of potential weakness.

Bank lending activity has been slow, with little growth beyond PPP loans.

After peaking in May 2020, total loan balances at commercial banks declined throughout the rest of the year. Respondents to the Federal Reserve's Senior Loan Officer Opinion Survey reported that both reduced demand and tighter lending standards, particularly at smaller banks, contributed to the decline in lending.[6]

Among the four major loan categories displayed in figure 6, the commercial and industrial (C&I) loan category observed the strongest growth. PPP loans accounted for most of the C&I loan growth over the first half of 2020. Leaving out PPP loans, C&I loans would have declined in 2020. The new second round of PPP loans also drove C&I loan growth between late-January and mid-March. Consumer lending has shown notable weakness during the COVID event. Consumer loan balances at commercial banks dropped 4 percent in 2020. Credit card loan balances, in particular, fell sharply in 2020. The reduction in credit card debt is likely the result of several factors, including tighter lending standards, lower spending, and the financial benefits of fiscal stimulus.

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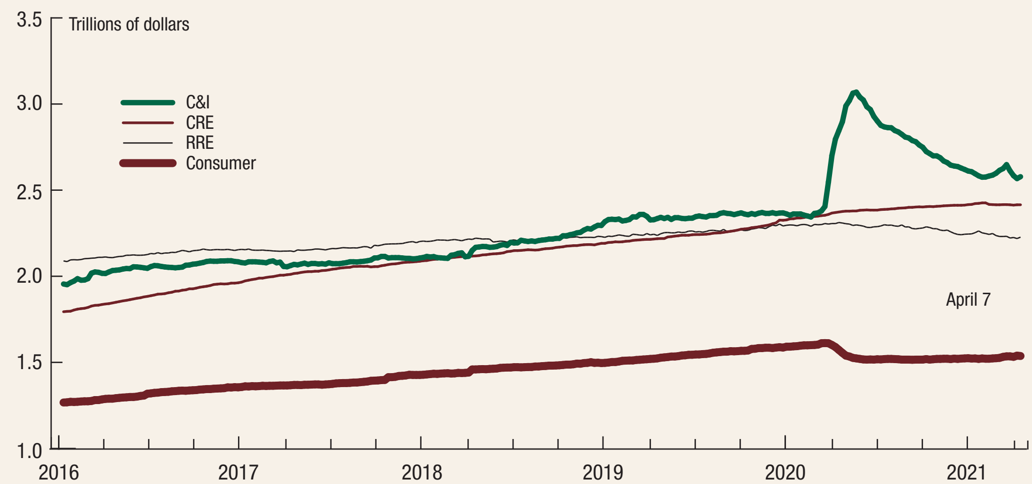
4 See the SBA's "Paycheck Protection Program (PPP) Report" at https://www.sba.gov/sites/default/files/2021-04/PPP_Report_Public_210418-508.pdf.

5 See the Federal Reserve Board announcement at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200409a.htm.

6 See the October 2020 and January 2021 "Senior Loan Officer Opinion Survey on Bank Lending Practices" at https://www.federalreserve.gov/data/sloos.htm.

Figure 6. Loans by type



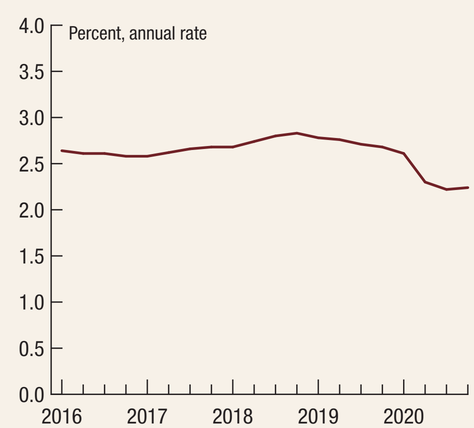
Note: Data are for all commercial banks.

Source: H.8, "Assets and Liabilities of Commercial Banks in the United States."

Decline in net interest margin accelerated in 2020.

Net interest margin, which represents a bank's yield on its financial assets after netting out interest expense, has declined over the past two years. It declined sharply in the first three quarters of 2020 and recovered slightly in the fourth quarter (figure 7).

Figure 7. Net interest margin



Source: Call Report and FR Y-9C.

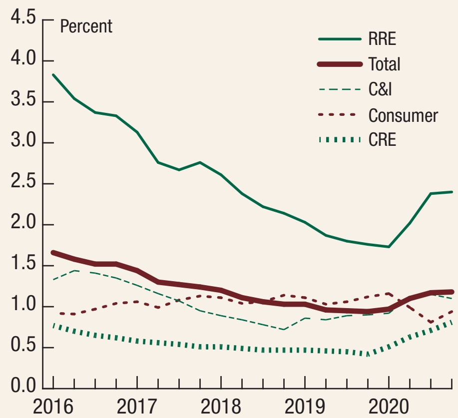
Net interest margin compression in 2020 was due to slow loan growth relative to deposit growth. As discussed earlier in the report, banks reported strong deposit growth in 2020 and invested much of the deposit inflow in lower yielding assets, such as cash and securities. Lower interest rates also contributed to the decline in net interest margin last year.

Delinquency rates slightly increased, and loan modification activity continues.

Although loan forbearance and loan modification programs have eased the burden on borrowers, delinquency rates for most loan types increased in 2020, though they remain low by historical standards.[7] Residential real estate (RRE) and commercial real estate (CRE) saw the

[7] Total loan delinquency rates approached 6 percent during the 2008 financial crisis. See the November 2018 *Supervision and Regulation Report* at https://www.federalreserve.gov/publications/2018-november-supervision-and-regulation-report-preface.htm.

Figure 8. Loan delinquency rates



Note: Delinquent loans are those 90+ days past due or in nonaccrual status.

Source: Call Report and FR Y-9C.

largest increases (figure 8). Some mortgage loans that did not enter forbearance may become delinquent due to COVID-event-related economic conditions. Supervisory data collected on large firms suggest the increase in CRE loan delinquency is driven by the retail and hospitality CRE loan sectors.

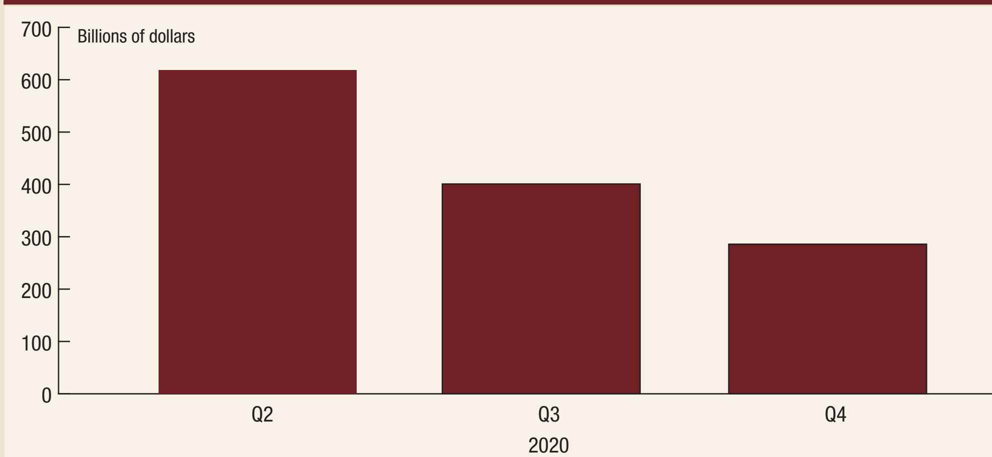
Banks increased loan loss reserves significantly in the first half of 2020 in anticipation of rising credit losses. While banks maintained high reserve levels in the second half of 2020, they lowered provisions. This indicates that banks considered loan loss reserves to be adequate. However, some banks are still reporting a high level of loan modifications and forbearance activity for borrowers affected by the COVID event. As discussed in box 1, loans under modification or forbearance programs might not be reported as delinquent loans even if interest payments are not received. Therefore, loan delinquency statistics may be understated.

Box 1: Loan Modifications Have Declined

Since the COVID event began, the Federal Reserve has encouraged banks to work prudently with their borrowers.[1] Banks can modify loan terms by deferring payments or reducing the interest rate. They can also extend the maturity date or adjust covenants and collateral requirements. These actions reduce financial pressure on borrowers and can help banks reduce loan losses. So far, banks appear to have been successful in helping many consumers and businesses weather the COVID event.

Section 4013 of the CARES Act eases certain accounting requirements when banks work with borrowers affected by the COVID event.[2] Banks began modifying loans, consistent with Section 4013, during the first quarter of 2020.[3] These loan modifications peaked in the second quarter of 2020 and have declined each quarter thereafter. At the end of 2020, banks held around $286 billion in Section 4013 modified loans (figure A).

Figure A. Section 4013 loans



Source: Call Report and FR Y-9C.

Based on information gathered from banks, consumer loan modification balances peaked in the second quarter of 2020, while commercial loan modification balances peaked in the third quarter of 2020. Mortgages account for the largest share of consumer loan modifications, and loans to the finance and insurance, manufacturing, retail, and hospitality sectors account for the largest share of commercial loan modifications.

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1 See SR letter 20-15, "Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," at https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm and SR letter 20-18, "Joint Statement on Additional Loan Accommodations Related to COVID-19," at https://www.federalreserve.gov/supervisionreg/srletters/SR2018.htm.

2 Section 4013 suspended the accounting requirement that a bank classify a loan as a troubled debt restructuring if the bank modified the loan because of the COVID event.

3 Section 4013 loans are a subset of banks' modified loans. They do not include troubled debt restructurings or loans modified not meeting other Section 4013 requirements (such as a loan more than 30 days past due prior to December 31, 2019).

Regulatory Developments

The Board took a number of policy actions from April 1, 2020 to April 15, 2021.[8] Many of these supported the flow of credit to help underpin economic recovery, while others advanced the Federal Reserve's objectives of improving transparency and efficiency in supervision and regulation. In addition, the Federal Reserve and other regulators issued statements to continue the public dialogue of how the Federal Reserve's approach to supervision and regulation should evolve based on new technology—such as artificial intelligence (AI)—and new risks—such as those related to operational resilience.[9]

These regulatory developments are set forth in table 1 and in the discussion below.

Table 1. Federal Reserve or interagency rulemakings/statements (proposed and final)
From 4/1/2020 to 4/15/2021

Date issued	Rule/guidance
4/3/2020	Interagency Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency and the CARES Act. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200403a1.pdf
4/6/2020	Agencies announce changes to the community bank leverage ratio. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm
4/6/2020	SR 20-10 Small Business Administration (SBA) and Treasury Small Business Loan Programs: https://www.federalreserve.gov/supervisionreg/srletters/SR2010.htm
4/7/2020	Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised). Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200407a.htm
4/15/2020	SR 20-11 Release of Updated Sections of the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money-Laundering Examination Manual: https://www.federalreserve.gov/supervisionreg/srletters/SR2011.htm
4/17/2020	Federal Reserve adopts a change in Regulation O to temporarily modify the Board's rules so that certain bank directors and shareholders can apply to their banks for a loan under the Small Business Administration's Paycheck Protection Program. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200417a.htm
4/27/2020	Agencies extend comment period on updates to resolution plan guidance for large foreign banks. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200427a.htm
4/30/2020	The FFIEC, on behalf of its members, issues a statement to address the use of cloud computing services and security risk-management principles in the financial services sector. FFIEC press release: https://www.ffiec.gov/press/pr043020.htm

(continued)

8 The Federal Reserve publishes Supervision and Regulation (SR) letters and Consumer Affairs (CA) letters to address significant policy and procedural matters related to the Federal Reserve System's supervisory responsibilities and its consumer compliance supervisory responsibilities, respectively.

9 See boxes 3, 4, and 8.

Table 1.—*continued*

Date issued	Rule/guidance
5/1/2020	Federal Reserve Board finalizes rule to extend by 18 months the initial compliance dates for certain parts of its single-counterparty credit limit rule. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200501a.htm
5/5/2020	Federal bank regulatory agencies modify the liquidity coverage ratio for banks participating in Money Market Mutual Fund Liquidity Facility and Paycheck Protection Program Liquidity Facility. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200505a.htm
5/8/2020	Federal financial regulatory agencies issue interagency policy statement on allowances for credit losses and interagency guidance on credit risk review systems. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200508a.htm
5/8/2020	SR 20-12 Interagency Policy Statement on Allowances for Credit Losses: https://www.federalreserve.gov/supervisionreg/srletters/SR2012.htm
5/8/2020	SR 20-13 Interagency Guidance on Credit Risk Review Systems: https://www.federalreserve.gov/supervisionreg/srletters/SR2013.htm
5/15/2020	Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm
5/20/2020	Federal agencies share principles for offering responsible small-dollar loans, including during periods of economic stress, natural disasters, or other extraordinary circumstances such as the public health emergency created by the COVID-19 event. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200520a.htm
6/15/2020	Federal Reserve Board resumes examination activities for all banks, after previously announcing a reduced focus on exam activity in light of the coronavirus response. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm
6/23/2020	Federal and state regulatory agencies issue examiner guidance for assessing safety and soundness considering the effect of the COVID-19 pandemic on financial institutions. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200623a.htm
6/23/2020	SR 20-15 Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions: https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm
6/24/2020	SR 20-16 Supervision of De Novo State Member Banks: https://www.federalreserve.gov/supervisionreg/srletters/SR2016.htm
6/25/2020	Financial regulators modify provisions of Volcker rule related to "covered funds." Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm
6/25/2020	Agencies finalize amendments to swap margin rule. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625b.htm
7/1/2020	Agencies provide largest firms with information for next resolution plans. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200701a.htm
7/1/2020	Financial regulators issue statement on managing the London Inter-Bank Offer Rate (LIBOR) transition. FFIEC press release: https://www.ffiec.gov/press/pr070120.htm

(continued)

Table 1.—*continued*

Date issued	Rule/guidance
7/15/2020	Federal Reserve extends a change in Regulation O to temporarily modify the Board's rules so that certain bank directors and shareholders can apply to their banks for a Small Business Administration's Paycheck Protection Program loan. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200715a.htm
8/3/2020	SR 20-18/CA 20-13 Joint Statement on Additional Loan Accommodations Related to COVID-19: https://www.federalreserve.gov/supervisionreg/srletters/SR2018.htm
8/21/2020	SR 20-21 Joint Statement on Bank Secrecy Act Due Diligence Requirements for Customers Who May Be Considered Politically Exposed Persons: https://www.federalreserve.gov/supervisionreg/srletters/SR2021.htm
8/26/2020	Agencies issue three final rules: • a final rule that temporarily modifies the community bank leverage ratio, as required by the CARES Act; • a final rule that makes more gradual, as intended, the automatic restrictions on distributions if a banking organization's capital levels decline below certain levels; and • a final rule that allows institutions that adopt the current expected credit losses, or "CECL," accounting standard in 2020 to mitigate the estimated effects of CECL on regulatory capital for two years. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200826a.htm
9/1/2020	Federal and state financial regulatory agencies issue interagency statement on supervisory practices regarding financial institutions affected by Hurricane Laura and California wildfires. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200901b.htm
9/21/2020	The Federal Reserve Board issues an Advance Notice of Proposed Rulemaking to modernize the regulations to implement the Community Reinvestment Act. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm
9/29/2020	Agencies issue two final rules: • a final rule that temporarily defers appraisal and evaluation requirements for up to 120 days after the closing of certain residential and commercial real estate transactions; and • a final rule that neutralizes—because of the lack of credit and market risk—the regulatory capital and liquidity effects for banks that participate in certain Federal Reserve liquidity facilities. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200929a.htm
9/30/2020	Federal Reserve Board invites public comment on proposal to update the Board's capital planning requirements to be consistent with other Board rules that were recently modified. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930a.htm
10/9/2020	SR 20-22 ISDA IBOR Fallback Protocol and IBOR Fallback Supplement: https://www.federalreserve.gov/supervisionreg/srletters/SR2022.htm
10/9/2020	SR 20-23 Interagency Order Granting an Exemption from Customer Identification Program Requirements for Loans Extended by Banks and Their Subsidiaries to All Customers to Facilitate Purchases of Property and Casualty Insurance Policies: https://www.federalreserve.gov/supervisionreg/srletters/SR2023.htm
10/20/2020	The federal banking agencies finalize a rule to limit the interconnectedness and reduce the impact from failure of the largest banking organizations. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020a.htm
10/23/2020	The Federal Reserve Board and the Financial Crimes Enforcement Network (FinCEN) issue for public comment a proposed rule that would amend the recordkeeping and travel rule regulations under the Bank Secrecy Act. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201023a.htm
10/29/2020	Agencies propose regulation on the role of supervisory guidance. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201029a.htm

(continued)

Table 1.—*continued*

Date issued	Rule/guidance
10/30/2020	Agencies release paper on operational resilience. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201030a.htm
11/6/2020	Agencies release a statement on reference rates for loans: https://www.federalreserve.gov/supervisionreg/srletters/SR2025.htm
11/19/2020	Federal Reserve Board issues final rule modifying the annual assessment fees for its supervision and regulation of large financial companies. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201119a.htm
11/19/2020	Agencies release fact sheet to clarify Bank Secrecy Act due diligence requirements for banks and credit unions that offer services to charities and nonprofits. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201119b.htm
11/20/2020	Agencies provide temporary relief to community banking organizations related to certain regulations and reporting requirements as a result of their growth in size from the COVID event. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201120a.htm
11/30/2020	Agencies issue statement on LIBOR transition. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201130a.htm
11/30/2020	Federal Reserve Board welcomes and supports release of proposal and supervisory statements that would enable clear end date for U.S. Dollar (USD) LIBOR and would promote the safety and soundness of the financial system. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201130b.htm
12/9/2020	Agencies announce finalized guidance for resolution plans of certain large foreign banks and provide information regarding the content of the next resolution plans for large foreign and domestic banks. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201209a.htm
12/18/2020	Federal Reserve Board issues guidance describing financial institutions which are subject to the Large Institution Supervision Coordinating Committee program: https://www.federalreserve.gov/supervisionreg/srletters/sr2030.htm
12/18/2020	Agencies propose requirement for computer security incident notification. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201218a.htm
1/19/2021	Federal Reserve Board finalizes a rule that updates the Board's capital planning requirements to be consistent with other Board rules that were recently modified. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210119a.htm
2/9/2021	Federal Reserve Board announces the second extension of a rule to bolster the effectiveness of the Small Business Administration's Paycheck Protection Program (PPP). Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210209a.htm
3/5/2021	Federal Reserve Board clarifies guidance as it relates to definitions for minority depository institutions. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210305a.htm
3/9/2021	Federal bank regulators issue rule supporting the Treasury's investments in minority depository institutions and community development financial institutions. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210309a.htm
3/9/2021	Federal Reserve Board issues guidance on assessing supervised institutions' plans to transition away from the use of LIBOR: https://www.federalreserve.gov/supervisionreg/srletters/SR2107.htm

(continued)

Table 1.—*continued*

Date issued	Rule/guidance
3/19/2021	Temporary supplementary leverage ratio changes to expire as scheduled. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210319b.htm
3/19/2021	Federal Reserve Board announces that the temporary change to its supplementary leverage ratio (SLR) for bank holding companies will expire as scheduled on March 31. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210319a.htm
3/25/2021	Federal Reserve announces temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, based on results from upcoming stress test. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210325a.htm
3/29/2021	Agencies seek wide range of views on financial institutions' use of artificial intelligence. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210329a.htm
3/31/2021	Federal Reserve Board issues guidance describing the application of its Large Institution Supervisory Coordinating Committee program to foreign banking organizations: https://www.federalreserve.gov/supervisionreg/srletters/sr2030.htm
3/31/2021	Federal Reserve Board adopts final rule outlining and confirming the use of supervisory guidance for regulated institutions. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210331a.htm
3/31/2021	Federal Reserve Board publishes frequently asked questions (FAQs) comprising existing legal interpretations related to a number of the Board's longstanding regulations. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210331b.htm
4/08/2021	Federal Reserve Board invites public comment on a proposal to automate non-merger-related adjustments to member banks' subscriptions to Federal Reserve Bank capital stock. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210408a.htm
4/09/2021	Agencies issue statement and request for information on Bank Secrecy Act/anti-money-laundering compliance. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210409a.htm

Box 2: Temporary Relief from Asset-Based Thresholds in Regulations

Asset-based thresholds in the Federal Reserve's regulations are designed, in part, to appropriately calibrate regulatory requirements given a banking organization's size. As a result of banks' response to the COVID event, including participation in the PPP, the balance sheets of some community banking organizations have grown unexpectedly since the beginning of 2020. Consequently, these institutions could become subject to new regulatory requirements.

Therefore, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) issued an interim final rule to provide temporary regulatory relief to community banking organizations to address the consequences of the unanticipated asset growth in 2020. This action provides community banking organizations with time to reduce their assets or prepare for additional regulatory and reporting standards.

The agencies' interim final rule permits community banking organizations[1] as of December 31, 2019, to use asset data as of December 31, 2019, to determine the applicability of various regulatory asset thresholds during calendar years 2020 and 2021.[2] This means that asset growth in 2020 or 2021 will not trigger new regulatory requirements, including reporting requirements. These banking organizations have until January 1, 2022, at the earliest, to address the unanticipated asset growth.

Similar to the relief provided in the interim final rule, the agencies temporarily revised applicable FFIEC Call Report instructions to provide reporting relief for those community banking organizations experiencing temporary asset growth.[3] Further, the Federal Reserve temporarily revised the reporting instructions for a number of its regulatory reports[4] for community holding companies to determine the applicability of asset-based reporting thresholds set at $10 billion or less using asset data as of December 31, 2019.[5] Therefore, a community bank's and community holding company's asset growth in 2020 or 2021 will not trigger new reporting requirements until January 1, 2022, at the earliest.

1 The interagency interim rule defines the term "community banking organizations" as national banks, savings associations, state banks, bank holding companies, savings and loan holding companies, and U.S. branches and agencies of foreign banking organizations with under $10 billion in total assets.

2 See 85 Fed. Reg. 77,345 (December 2, 2020). The notice provides a summary of the regulations with asset-based regulatory thresholds that are covered by the interagency interim rule. https://www.federalregister.gov/documents/2020/12/02/2020-26138/temporary-asset-thresholds.

3 See 86 Fed. Reg. 10,157 (February 18, 2021) and appendix A for the definition of the FFIEC Call Reports. https://www.federalregister.gov/documents/2021/02/18/2021-03210/agency-information-collection-activities-submission-for-omb-review-comment-request.

4 See 85 Fed. Reg. 77,351–77,352 (December 2, 2020) for Table 1, Reporting Requirements for Affected Federal Reserve Reports Under Interim Final Rule and After Regulatory Burden Relief Ends, available at www.federalregister.gov/documents/2020/12/02/2020-26138/temporary-asset-thresholds.

5 The following regulatory reports were temporarily revised: Financial Statements for Holding Companies (FR Y-9 reports; OMB No. 7100-0128); Statements of U.S. Nonbank Subsidiaries of U.S. Holding Companies (FR Y-11 and FR Y-11S; 7100-0244) (FR Y-11 reports); Reports of Foreign Banking Organizations (FR Y-7N, FR Y-7NS, and FR Y-7Q; 7100-0125) (FR Y-7 reports); and Statements of Foreign Subsidiaries of U.S. Banks (FR2314 and FR 2314S; OMB No. 7100-0073) (FR 2314 reports).

Box 3: Exploring Artificial Intelligence

Banks use artificial intelligence (AI) in a growing number of areas, including fraud monitoring, customer service, trading, and loan underwriting. This has prompted the Federal Reserve to explore how best to support the responsible use of AI and provide clarity around supervisory expectations.

The Federal Reserve is seeking input from a broad variety of stakeholders on these questions. In December 2020, the Federal Reserve, the FDIC, the OCC, and the Consumer Financial Protection Bureau (CFPB) co-hosted a public session to explain the current regulatory landscape and highlight commonly asked questions. Over 3,000 attendees participated, including supervised institutions, AI technology vendors, and consumer advocates.

In January 2021, the Federal Reserve held a two-day academic symposium on AI with over 2,000 attendees, including regulators, members of the financial services industry, consumer advocates, and academics. The symposium included some of the leading researchers in the field and generally focused on potential benefits and limits of AI. The speakers discussed the importance of understanding how AI systems make decisions and reviewed various techniques under development to provide that transparency.

On March 29, the Federal Reserve, the FDIC, the OCC, the CFPB, and the National Credit Union Administration issued a request for information on the risk management of AI applications in financial services. The request for information addresses a wide range of AI-related topics, including the potential for a lack of transparency in AI models, the use of data in AI applications, cybersecurity risks, and fair lending considerations. The responses will be used to inform whether additional clarity around supervisory expectations on the use of AI is warranted.

Supervisory Developments

The Federal Reserve supervises financial institutions to assess their safety and soundness and compliance with laws and regulations. This section provides an overview of key supervisory developments related to supervised institutions. The section distinguishes between large financial institutions and community and regional banking organizations because supervisory approaches and priorities differ across these groups.

The Federal Reserve also conducts consumer-focused supervision to promote a fair and transparent financial services marketplace and to ensure that the financial institutions under the Federal Reserve's jurisdiction comply with applicable federal consumer protection laws and regulations. More information about the Federal Reserve's consumer-focused supervisory program can be found in the Federal Reserve's *106th Annual Report 2019*.[10]

Key Supervisory Priorities

In response to the disruptions posed by the COVID event, Federal Reserve supervisors have conducted examination and monitoring activities to assess whether financial institutions have the financial and operational strength to meet the challenges faced by their customers and local communities.

Since the start of the COVID event, supervisors have focused on the extent to which banking organizations understand their risks, estimate expected losses appropriately, and take action to conserve capital where prudent.[11] The Federal Reserve has evaluated the actions that firms have taken to accommodate their borrowers, as described above in box 1.

In addition, Federal Reserve supervisors have focused on whether firms are able to withstand and recover from disruptions to their operations. Operational incidents can range in scope, severity, and impact to individual firms and the broader financial system. Supervisors also evaluate the ability of firms to adapt to changes in market standards and accounting rules. These changes include a firm's transition from using LIBOR to alternative reference rates (discussed in box 4) and a firm's implementation of CECL (as discussed in the November 2020 *Supervision and Regulation Report*).

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[10] See *106th Annual Report 2019*, section 5, "Consumer and Community Affairs," at https://www.federalreserve.gov/publications/annual-report.htm.

[11] For more information on the Federal Reserve's approach to evaluating resiliency in light of the COVID event, see SR letter 20-15, "Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," at https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm.

Box 4: Ensuring Adequate Planning to Transition away from LIBOR

The Federal Reserve is increasing supervisory attention on banks' efforts to transition away from LIBOR. On March 9, 2021, the Federal Reserve issued supervisory guidance for examiners to use in assessing institutions' LIBOR transition plans.[1] This guidance reinforces an interagency statement issued by the Federal Reserve, the FDIC, and the OCC on November 30, 2020, that encouraged firms to stop issuing new LIBOR contracts as soon as practicable, and in any event by December 31, 2021.[2]

Examiners will confirm that firms are adequately planning for the transition. Firms should be tracking the number of their LIBOR exposures, modifying IT systems and models that use LIBOR, and identifying contracts that refer to LIBOR. Examiners will share findings with banks and may issue recommendations for action if a firm is not making appropriate progress.

The transition away from LIBOR will require significant attention over the next year. Banks that write new LIBOR-based contracts should include robust fallback language and define an alternative reference rate in such contracts after LIBOR is no longer available. In addition, banks should identify other potential risks related to the change and work to mitigate those risks ahead of the anticipated end to LIBOR.

1 See SR letter 21-7, "Assessing Supervised Institutions' Plans to Transition Away from the Use of the LIBOR," at https://www.federalreserve.gov/supervisionreg/srletters/SR2107.htm.

2 See SR letter 20-27, "Interagency Statement on LIBOR Transition," at https://www.federalreserve.gov/supervisionreg/srletters/SR2027.htm.

Transparency in Supervision

The Federal Reserve continues to focus on increasing transparency, simplicity, and predictability in supervision.

In 2020, the Federal Reserve published additional information regarding the supervisory program for the largest, most complex firms—the LISCC supervisory program—and simplified the scope of the supervisory program to include U.S. global systemically important banks (G-SIBs) and other firms that pose similar risk to U.S. financial stability.[12] Last month, the Federal Reserve provided clarity to foreign banking organizations, scoping in a foreign banking organization to the LISCC supervisory program if its U.S. operations have a risk profile similar to a U.S. G-SIB.[13] The revised scope of the LISCC supervisory program increases transparency and aligns the Federal Reserve's supervisory program with the current risk-based categories in its regulatory framework.

The Federal Reserve provided additional transparency to all supervised institutions by updating the process that a supervised institution uses to appeal a material supervisory determination. It also published additional information about the Board's Ombudsman Office, which

12 Specifically, these institutions include savings and loan holding companies with a risk profile similar to a U.S. G-SIB and nonbank financial companies supervised by the Board.

13 See SR letter 20-30, "Firms Subject to the LISCC Supervisory Program," at https://www.federalreserve.gov/supervisionreg/large-institution-supervision.htm.

Box 5: The Board's Ombudsman Office

The Office of the Ombudsman has three major functions. Primarily, the office resolves complaints related to the System's supervisory and regulatory activities. For example, financial institutions can contact the Office of the Ombudsman about supervisory component and composite ratings; findings in safety and soundness and consumer compliance examinations; and timing, process, or other concerns relating to examinations.

Second, the Office of the Ombudsman investigates any claim that System staff has retaliated against a supervised institution, which the Board strictly prohibits. The Board's Ombudsman Policy Statement defines retaliation as any action or decision by Board or Reserve Bank staff that causes a supervised institution to be treated differently or more harshly than other similarly situated institutions.[1]

Third, the Office of the Ombudsman provides feedback to Board members and senior staff about complaints raised by supervised institutions that are likely to have a significant effect on the Federal Reserve's missions, activities, or reputation.

The Office of the Ombudsman is also involved in a supervised institution's appeal of a material supervisory determination. See appendix A for a definition of "material supervisory determinations." In 2020, the Board amended these policies, drawing on its experience, to improve and expedite the appeals process.[2]

[1] Refer to the Board's public website at https://www.federalreserve.gov/aboutthefed/ombpolicy.htm.

[2] Refer to SR letter 20-28/CA letter 20-14, "Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System," at https://www.federalreserve.gov/supervisionreg/srletters/SR2028.htm.

facilitates the fair and timely resolution of complaints related to the System's supervisory and regulatory activities. These updates are described in box 5.

The Federal Reserve is expanding its outreach efforts, with a particular emphasis on smaller institutions. Recently, the Federal Reserve joined the FDIC in publishing the examination procedures that are used for CBOs and RBOs.[14] Through the Ask the Fed program, the Federal Reserve continues to host webinars with supervised institutions and senior Board officials and subject matter experts about new or important regulations and supervisory guidance. For CBOs and RBOs, the Federal Reserve issues the *Community Banking Connections* publication that addresses the challenges and concerns facing smaller institutions.[15]

In December 2020, the Federal Reserve initiated a public dialogue on the questions of transparency and due process through a public conference on bank supervision, co-hosted with Harvard Law School and the Wharton School of the University of Pennsylvania, as discussed in box 6.

[14] Refer to the Board's public website for the Examination Documentation modules at https://www.federalreserve.gov/publications/examination-documentation-modules.htm.

[15] Refer to the *Community Banking Connections* website at www.communitybankingconnections.org.

Box 6: Conference on Bank Supervision: Theory and Practice in Supervision

On December 11, 2020, the Federal Reserve Board, the Harvard Law School, and the Wharton School of the University of Pennsylvania co-hosted a conference to discuss the theory and practice of bank supervision. This conference brought together academics, supervisors, bankers, and other stakeholders. Over 1,500 people watched the live virtual event.

The conference included four panel discussions. Federal Reserve Vice Chair for Supervision Randal K. Quarles and FDIC Chair Jelena McWilliams also gave remarks. The opening panel highlighted why supervision is important and how it adapts to the business cycle. Panelists argued that supervision differs from, and is complementary to, regulation. They also debated whether the discretion inherent in the supervisory process allows it to fill gaps that cannot be addressed through regulation. The second panel tackled the issue of transparency, focusing on disclosure of confidential supervisory information. Panelists noted that the desired balance between transparency and confidentiality may shift in times of stress.

In his keynote speech, Vice Chair Quarles highlighted the differences between supervision and regulation. He also emphasized the importance that both systems remain simple, predictable, and transparent.

The conference discussion also explored the tension between discretion and due process. Panelists noted that though bank supervision must be flexible to be effective, it should also include procedural safeguards to be fair. The conference concluded by considering future areas for research, including collaboration between academics and supervisory authorities.

Links to conference materials and video replays are available on the Board's public website at https://www.federalreserve.gov/conferences/conference-on-bank-supervision.htm.

Supervised Institutions

The Federal Reserve supervises bank holding companies, savings and loan holding companies, and state member banks of varying size and complexity. The Federal Reserve follows a risk-focused approach by scaling its supervisory work to the size and complexity of an institution.[16]

- Firms identified as posing elevated risk to U.S. financial stability are supervised by the Large Institution Supervision Coordinating Committee, or LISCC, program.
- U.S. firms with $100 billion and greater in assets, and foreign banking organizations with combined U.S. assets of $100 billion and greater, that are not supervised within the LISCC

[16] Federal Reserve examiners work with staff in the Board's Division of Consumer and Community Affairs to review a state member bank's performance under the Community Reinvestment Act (CRA) as well as assessment of compliance with and enforcement of a wide range of consumer protection laws and regulations, for example, those related to fair lending, unfair or deceptive acts or practices (UDAP), and flood insurance.

program are supervised by the Large and Foreign Banking Organization, or LFBO program.[17]

- Regional banking organizations (RBOs)—firms with total assets between $10 billion and $100 billion—are supervised by the RBO program.
- Community banking organizations (CBOs)—firms with less than $10 billion in total assets—are supervised by the CBO program.

Table 2 provides an overview of the organizations supervised by the Federal Reserve, by portfolio, including the number of institutions and total assets in each portfolio.

Table 2. Supervised institutions (data as of Q4:2020)

Portfolio	Definition	Number of institutions	Total assets ($ trillions)
Large Institution Supervision Coordinating Committee (LISCC)	Eight U.S. global systematically important banks (G-SIBs)	8	13.5
State member banks (SMBs)	SMBs within LISCC organizations	4	1
Large and foreign banking organizations (LFBOs)	Non-LISCC U.S. firms with total assets $100 billion and greater and FBOs	174	9.1
Large banking organizations (LBOs)	Non-LISCC U.S. firms with total assets $100 billion and greater	16	4.2
Large FBOs	FBOs with combined assets $100 billion and greater	17	3.6
Small FBOs (excluding rep offices)	FBOs with combined assets less than $100 billion	110	1
Small FBOs (rep offices)	FBO U.S. representative offices	30	0
State member banks	SMBs within LFBO organizations	9	1.2
Regional banking organizations (RBOs)	Total assets between $10 billion and $100 billion	89	2.5
State member banks	SMBs within RBO organizations	39	0.9
Community banking organizations (CBOs)	Total assets less than $10 billion	3,696*	2.7
State member banks	SMBs within CBO organizations	682	0.6
Insurance and commercial savings and loan holding companies (SLHCs)	SLHCs primarily engaged in insurance or commercial activities	7 insurance 4 commercial	1.1

Note: The three LISCC FBOs transferred from the LISCC portfolio to the LFBO portfolio effective 1/1/2021. These three firms have been moved to the LFBO portfolio in the table above.

* Includes 3,638 holding companies and 58 state member banks that do not have holding companies.

Large Financial Institutions

This section of the report discusses the supervisory approach for large financial institutions supervised within the LISCC or LFBO portfolios, which are U.S. firms with assets of $100 billion and greater and foreign banking organizations with combined U.S. assets of $100 billion and greater. These firms are separated into categories used for applying regulatory requirements, as set forth in table 1.A in appendix A.

[17] The LFBO program also supervises foreign banking organizations with combined U.S. assets of less than $100 billion.

Supervisory efforts in this portfolio are organized to focus on four specific components: (1) capital planning and positions, (2) liquidity risk management and positions, (3) governance and controls, and (4) recovery and resolution planning.[18] On the whole, firms are generally meeting or exceeding supervisory expectations with respect to capital planning and positions and liquidity risk management and positions. However, challenges continue to remain for some firms, particularly related to governance and controls.

Given the nature of issues presented by the COVID event, this report focuses on supervisory developments related to large financial institutions' capital planning and positions and their governance and controls.

Large financial institutions remain well capitalized on a current and post-stress basis.

Large financial institutions remain well capitalized and able to support lending. The aggregate CET1 capital ratio for large bank holding companies in the fourth quarter of 2020 was 12.8 percent, an increase compared to the end of 2019 despite the disruptions to economic activity during 2020.[19]

Stress testing has been an important supervisory tool during the COVID event to assess large banks' financial resilience. In December 2020, the Federal Reserve completed its second stress test of 2020, which showed that large bank holding companies would maintain strong capital levels under two separate hypothetical recessions. Under both scenarios, large banks would collectively have more than $600 billion in total losses. These losses are considerably higher than those in the first stress test of 2020, conducted six months earlier. However, bank capital ratios would remain well above the 4.5 percent minimum, declining from an average starting point of 12.2 percent to 9.6 percent in the more severe scenario.

In light of ongoing economic uncertainty and to preserve the strength of the banking sector, the Board imposed temporary and additional restrictions on bank holding company dividends and share repurchases. Through the first half of 2021, dividends and share repurchases, combined, are limited to an amount based on income over the past year. The temporary and additional restrictions will end for most firms after June 30, 2021, after completion of the upcoming round of stress tests. Firms with stress test results reflecting risk-based capital levels above their minimum requirements will no longer be subject to the additional restrictions after June 30. Instead, these firms will be subject to restrictions based on the Board's regular capital framework, the stress capital buffer. Firms with stress test results reflecting risk-based capital levels below their minimum requirements will remain subject to the restrictions.

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[18] The Federal Reserve focuses on recovery planning for LISCC firms only. For more information regarding the framework for supervision of large financial institutions, see SR letter12-17/ CA letter 12-14, "Consolidated Supervision Framework for Large Financial Institutions," at https://www.federalreserve.gov/supervisionreg/srletters/sr1217.htm; and box 4 of the November 2018 *Supervision and Regulation Report* at https://www.federalreserve.gov/publications/2018-november-supervision-and-regulation-report-preface.htm.

[19] Large banks include all bank holding companies and intermediate holding companies with $100 billion and greater in total consolidated assets.

The Federal Reserve has conducted several horizontal examinations in order to assess how firms were adapting their capital planning in response to the COVID event.[20] In the coming year, the Federal Reserve will focus its supervisory efforts on risk identification and risk-management practices, such as the efforts of firms to identify risks and estimate losses in the current environment, the soundness of firms' internal risk-rating processes, and the adequacy of firms' credit loss recognition and loan review practices. For more detail on supervisory priorities for large financial institutions, see box 7.

Box 7: Upcoming Large Financial Institution Supervisory Priorities

Capital

- Credit risk, including areas such as internal risk rating accuracy, credit loss recognition, loan review, and credit risk rating process
- Estimation of credit losses and identification of risks in the post-COVID environment
- Earnings pressures and the ability to sustain sound capital levels
- Board effectiveness and engagement, including risk identification and scenario design practices

Liquidity

- Internal liquidity stress testing scenarios, assumptions, and methodologies
- Liquidity risk limits and related governance processes
- Daily and short-term liquidity risk-management monitoring programs

Governance and controls

- Operational resilience, including cyber-related and information technology risks
- Compliance risk management, including Bank Secrecy Act/anti-money-laundering programs and Office of Foreign Assets Control compliance
- LIBOR transition preparedness

Recovery and resolution planning

- Resolution plan and critical operations reviews
- Recovery planning (for LISCC firms)
- International coordination

Large financial institutions have shown operational resilience to the COVID event.

A firm's operational resilience—or its ability to withstand and recover from stressful events—is a key supervisory focus for large financial institutions (see box 8). In assessing a large firm's operational resilience, the Federal Reserve evaluates a firm's governance, resilience of its information systems, and recovery capabilities. In 2020, large firms have shown operational resilience to the COVID event, as they have continued to provide critical business services to their clients over the last year. Digitization of banking activities allowed firms to continue these operations in the remote work environment.

Effective management of cybersecurity risk is a key component of operational resiliency. In response to growing cybersecurity risks over the past few years, the Federal Reserve, along with the FDIC and the OCC, has established a program to partner on cybersecurity reviews at the largest and most complex financial institutions. These efforts are designed to reduce regulatory overlap while increasing supervisory efficacy, consistency, and efficiency. The interagency exams first began in 2020 and are continuing this year.

[20] For more information on supervisory observations from these exercises, see the November 2020 *Supervision and Regulation Report* at https://www.federalreserve.gov/publications/2020-november-supervision-and-regulation-report.htm.

Box 8: Interagency Paper Outlines Sound Practices to Strengthen Operational Resilience

On October 30, 2020, the federal bank regulatory agencies released a paper outlining sound practices designed to help large banks increase their operational resilience.[1] Examples of risks to operational resilience include cyberattacks, natural disasters, and pandemics.

The paper outlines practices to increase operational resilience at large banks that are drawn from existing regulations, guidance, statements, and common industry standards. The practices are grounded in effective governance and risk-management techniques, consider third-party risks, and include resilient information systems. The paper does not revise the agencies' existing rules or guidance. The agencies intend to hold discussions with the public on further steps to improve operational resilience.

[1] See SR letter 20-24, "Interagency Paper on Sound Practices to Strengthen Operational Resilience," at https://www.federalreserve.gov/supervisionreg/srletters/SR2024.htm.

Community and Regional Banking Organizations

This section of the report discusses the supervisory approach for banking organizations with assets less than $100 billion. These institutions include CBOs, which have less than $10 billion in total assets, and RBOs, which have total assets between $10 billion and $100 billion.

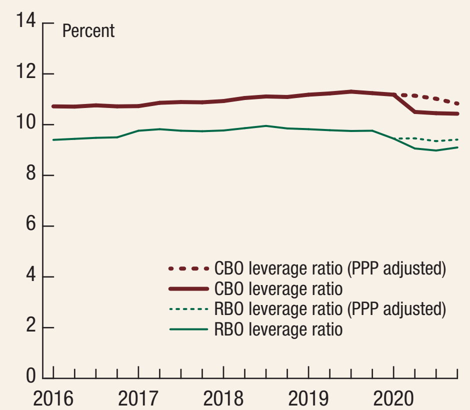
Most CBOs and RBOs remain in stable condition as of the end of 2020.

CBOs and RBOs generally report stable operational and credit conditions. However, they acknowledge continued uncertainty about the future performance of loans to industries and businesses most affected by the COVID event. While the aggregate tier 1 leverage ratio for CBOs and RBOs has declined since the beginning of 2020, this ratio remained relatively robust as of year-end 2020. As noted in figure 9, the aggregate tier 1 leverage is 10 percent for CBOs and nearly 9 percent for RBOs.

In addition, the number of CBOs and RBOs reporting losses has declined throughout the year. While roughly 5 percent of CBOs and 13 percent of RBOs were reporting net losses as of mid-year 2020, only 3.5 percent of CBOs and 7.5 percent of RBOs have reported losses as of year-end 2020. Further, CBOs and RBOs report generally stable or increasing liquidity levels and lower reliance on noncore funding.

Based on recent supervisory activities, the Federal Reserve has found that CBOs and RBOs are generally addressing the risks arising from the COVID event within their loan portfolios and operations. In these activities, the Federal Reserve has found that many CBOs and RBOs have increased their reliance on technology to help their customers and communities through the COVID event. The Federal Reserve expects institutions to monitor and mitigate cyber threats and remain vigilant, including maintaining preventive and detective controls. As CBOs and RBOs increase their reliance on third parties for technology services, the Federal Reserve has emphasized the importance of sound risk management for an institution's third-party risk exposure.

Figure 9. Tier 1 leverage ratio (CBOs and RBOs)



Note: The PPP-adjusted leverage ratio was computed by subtracting PPP covered loans outstanding from the ratio's denominator, and then adding back to the denominator the quarterly average amount of PPP covered loans pledged to the PPPLF that were excluded from total assets for the leverage ratio.

Source: Call Report and FR Y-9C.

Most CBOs and RBOs project flat or minimal loan growth in 2021. Increasing credit risks are evident in those borrowers adversely affected by the COVID event. As many CBOs and RBOs are commercial real estate lenders, the Federal Reserve is closely monitoring the condition of banks with concentrations of commercial real estate loans.

Box 9: CBO and RBO Supervisory Priorities

Overall

- Capital and liquidity resiliency
- Risk-identification and management practices

Credit risk

- Loan modifications
- High-risk loan portfolios
  - —commercial real estate loan portfolios
  - —loans to borrowers in industries affected by the COVID event
- Underwriting practices and asset growth
- Reserve practices and levels

Capital

- Capital planning, projections, needs, and vulnerabilities
- Capital actions
- Earnings assessment

Operational risk

- Continuity of operations
- Information technology and cybersecurity

The Federal Reserve continues to focus on high-risk CBOs and RBOs.

The Federal Reserve resumed examinations of CBO and RBO firms in June 2020 and remains focused on assessing the overall safety and soundness of CBOs and RBOs and the effectiveness of their risk management.[21] In particular, the Federal Reserve is placing a priority on the examination of high-risk CBOs and RBOs and assessing their financial resiliency. Since resuming examinations, state member bank ratings have remained relatively stable.

The Federal Reserve is also closely monitoring asset quality measures of CBOs and RBOs and their processes for credit loss recognition. To aid in prioritizing supervisory activities, the Federal Reserve continues to regularly engage with CBOs and RBOs to understand their operational capacity and challenges. Refer to box 9 for CBO and RBO Supervisory Priorities for the remainder of 2021.

[21] For a discussion on the resumption of examinations following the examination pause from March 2020 to June 2020, see the November 2020 *Supervision and Regulation Report* at https://www.federalreserve.gov/publications/2020-november-supervision-and-regulation-report.htm.

Appendix A: Definitions of Data Sources and Terms

Definition of Data Sources

The Supervision and Regulation Report includes data on institutions supervised by the Federal Reserve System, as well as institutions that are not so supervised. The report reflects data through April 15, 2021. This appendix details these sources.

FFIEC Call Reports

The FFIEC Consolidated Reports of Condition and Income, also known as the Call Report, is a periodic report that is required to be completed by every national bank, state member bank, insured nonmember bank, and savings association as of the last day of each calendar quarter. The details required to be reported depend on the size of the institution, the nature of the institution's activities, and whether or not it has foreign offices. Call Report data are a widely used source of timely and accurate financial data regarding a bank's financial condition and the results of its operations. The data collected from the Call Report are used to monitor the condition, performance, and risk profiles of the institutions as individuals and as an industry.

FR Y-9C

The Consolidated Financial Statement for Holding Companies, also known as the FR Y-9C report, collects basic financial data from domestic bank holding companies (BHCs), savings and loan holding companies (SLHCs), U.S. intermediate holding companies (IHCs), and securities holding companies (SHCs). Respondent burden reduction initiatives led to the asset-sized threshold change from $500 million to $1 billion, and from $1 billion to $3 billion effective March 2015 and September 2018, respectively. In addition, BHCs, SLHCs, U.S. IHCs, and SHCs meeting certain criteria may be required to file this report, regardless of size. However, when such BHCs, SLHCs, U.S. IHCs, or SHCs own or control, or are owned or controlled by, other BHCs, SLHCs, U.S. IHCs, or SHCs, only top-tier holding companies must file this report for the consolidated holding company organization. The information contained in the report is as of the last day of each calendar quarter.

H.8—Assets and Liabilities of Commercial Banks in the United States

The H.8 release provides an estimated weekly aggregate balance sheet for all commercial banks in the United States. The H.8 release is primarily based on data that are reported weekly by a sample of approximately 875 domestically chartered banks and foreign-related institutions. Data for domestically chartered commercial banks and foreign-related institutions that do not report weekly are estimated at a weekly frequency based on quarterly Call Report data.

Notes on Specific Data Sources and Terms

Commercial Real Estate Loans

The sum of construction, land development, and other land loans; loans secured by multifamily residential properties; and loans secured by other nonfarm nonresidential properties.

Common Equity Tier 1

Common equity capital is currently evaluated using a common equity tier 1 (CET1) capital ratio, which was introduced into the regulatory capital framework with the implementation of Basel III. The CET1 capital ratio is defined as CET1 capital as a percent of risk-weighted assets. Advanced approaches institutions are required to report risk-weighted assets using an internal model-based approach and a standardized approach. An advanced approaches institution is subject to the lower of the ratios. CBOs that have opted into the community bank leverage ratio (CBLR) framework are not required to report a CET1 capital ratio and risk-weighted assets.

From 2006 through 2013, tier 1 common was used to measure common equity capital for all firms. In 2014, both tier 1 common capital (for non-advanced approaches firms) and CET1 capital (for advanced approaches firms) were used. From 2015 to present, CET1 capital has been used for all firms.

Community Bank Leverage Ratio Framework

The CBLR framework, which became effective January 1, 2020, allows qualifying CBOs to adopt a simple leverage ratio to measure capital adequacy. To qualify for the framework, a CBO must have less than $10 billion in total consolidated assets, have limited trading activity and off-balance-sheet exposure, meet the leverage ratio requirement, and not be part of an advanced approaches banking organization. The leverage ratio requirement for the CBLR framework was temporarily lowered to 8 percent beginning in the second quarter of 2020 through the remainder of calendar year 2020. The requirement will be set at 8.5 percent for calendar year 2021 and will return to its previous 9 percent level beginning January 1, 2022.

The leverage ratio requirement for the CBLR framework is defined as tier 1 capital as a percent of average total consolidated assets for the quarter as reported on Schedule RC-K on the Call Report or Schedule HC-K on Form FR Y-9C, as applicable. A CBLR banking organization with a ratio above the requirement will not be subject to other capital and leverage requirements.

Consumer Loans

Consumer loans include credit cards, other revolving credit lines, automobile loans, and other consumer loans (includes single payment and installment loans other than automobile loans, and all student loans).

Credit Default Swap Spread

The five-year credit default swap spread is the premium payment expressed as a proportion of the notional value of the debt which is being insured against default (typically $10 million in senior debt) in basis points. Data are based on daily polls of individual broker-dealers worldwide. Note that these broker quotes are typically not transaction prices. Data provided are for LISCC firms only.

Delinquent Loans

Delinquent loans are the sum of 90+ days past due loans and nonaccrual loans.

Liquid Assets

Liquid assets are cash plus estimates of securities that qualify as high-quality liquid assets, as defined by the Board's liquidity coverage ratio rule.

Loan Loss Reserves

Loan loss reserves represent the allowance for credit losses on a bank's portfolio of loans and leases.[22] Loan loss reserves are recorded as a contra asset on a bank's balance sheet and netted against gross loans and leases.

Loan Modifications under Section 4013 of the CARES Act

Section 4013 of the CARES Act (and further amendments by the Consolidated Appropriations Act, 2021) allows financial institutions to suspend the requirements to classify certain loan modifications as troubled debt restructurings. To be an eligible loan under section 4013, a loan modification must be: (1) related to COVID-19; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (a) 60 days after the date of termination of the National Emergency or (b) January 1, 2022 (referred to as the "applicable period").

Market Leverage

The market leverage ratio—defined as the ratio of the firm's market capitalization to the sum of market capitalization and the book value of liabilities—can be considered a market-based measure of firm capital (expressed in percentage points). Data provided are for LISCC firms only.

Material Supervisory Determination

As explained in SR letter 20-28/CA letter 20-14, a "material supervisory determination" includes, but is not limited to, any material determination relating to examination or inspection composite ratings, material examination or inspection component ratings, the adequacy of loan loss reserves and/or capital, significant loan classification, accounting interpretation, Matters Requiring Attention (MRAs), Matters Requiring Immediate Attention (MRIAs), Community Reinvestment Act ratings (including component ratings), and consumer compliance ratings. The term does not include any supervisory determination for which an independent right of appeal exists or a referral to another government agency.

Provisions

Provisions represent the amount necessary to adjust loan loss reserves to reflect management's current estimate of expected credit losses on loans and leases. Provisions are recorded as an expense item on the bank's income statement.

Residential Real Estate Loans

Loans secured by one to four family residential properties, including: revolving, open-end loans secured by one to four family residential properties and extended under lines of credit; closed-end loans secured by first liens on one to four family residential properties; and closed-

[22] Allowance for Loan and Lease Losses was changed to Allowance for Credit Losses on Loans and Leases Held for Investment under the CECL methodology, adopted in the first quarter of 2020.

end loans secured by junior (i.e., other than first) liens on one to four family residential properties.

Top Holder

All data, unless otherwise noted, use top-holder data. This population generally comprises top-tier Call Report filers and top-tier Y-9C filers, including depository SLHCs and foreign banking organizations. In instances where a top-tier holding company does not file the Y-9C, we combine financial data of subsidiary banks/thrifts to approximate the consolidated financial data of the holding company. Commercial and insurance SLHCs, cooperative banks, and Federal Reserve member non-deposit trust companies are excluded from the top-holder population.

Tailoring of Regulation

In October 2019, the Board adopted rules that tailor its regulations for domestic and foreign banks to more closely match their risk profiles.[23] The rules establish a framework that sorts banks with $100 billion or more in total assets into four categories based on several factors, including asset size, cross-jurisdictional activity, reliance on weighted short-term wholesale funding (wSTWF), nonbank assets (NBA), and off-balance-sheet exposure (table 1.A).

Table 1.A. List of domestic and foreign firms, by category, as of 2020:Q4

Firm type	Category I U.S. G-SIBs	Category II >=$700b total assets or >=$75b in cross-jurisdictional activity	Category III >=$250b total assets or >=$75b in NBA, wSTWF, or off-balance-sheet exposure	Category IV Other firms with $100b to $250b total assets
Domestic firms				
U.S. domestic banking organization	Bank of America Bank of New York Mellon Citigroup Goldmans Sachs JPMorgan Chase Morgan Stanley State Street Wells Fargo	Northern Trust	Capital One Charles Schwab PNC Financial Truist Financial U.S. Bancorp	Ally Financial American Express Citizens Financial Discover Fifth Third Huntington KeyCorp M&T Bank Regions Financial Synchrony Financial
Foreign firms (standards vary by legal entity)				
Intermediate holding company			Barclays US Credit Suisse USA Deutsche Bank USA DWS USA HSBC North America TD Group US UBS Americas	BBVA USA BMO Financial BNP Paribas USA MUFG Americas RBC US Santander Holdings USA

(continued)

[23] Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23662.pdf.

Table 1.A.—*continued*

Firm type	Category I U.S. G-SIBs	Category II >=$700b total assets or >=$75b in cross-jurisdictional activity	Category III >=$250b total assets or >=$75b in NBA, wSTWF, or off-balance-sheet exposure	Category IV Other firms with $100b to $250b total assets
Combined U.S. operations		Barclays Credit Suisse Deutsche Bank MUFG Sumitomo Mitsui	Bank of Montreal BNP Paribas HSBC Mizuho Royal Bank of Canada Toronto-Dominion UBS	Banco Santander Bank of Nova Scotia BBVA BPCE Societe Generale

Note: NBA is nonbank assets, wSTWF is weighted short-term wholesale funding.

Source: FR Y-15, FR Y-9C, FR Y-7Q, 2020:Q1-2020:Q4.

Appendix B: Abbreviations

AI	artificial intelligence
BHC	bank holding company
CAMELS	Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk
CARES Act	Coronavirus Aid, Relief, and Economic Security Act
CBLR	community bank leverage ratio
CBO	community banking organization
CCAR	Comprehensive Capital Analysis and Review
CDS	credit default swap
CECL	current expected credit loss
CET1	common equity tier 1
CFPB	Consumer Financial Protection Bureau
CRA	Community Reinvestment Act
CRE	commercial real estate
C&I	commercial and industrial
FBO	foreign banking organization
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
G-SIB	global systemically important bank
HCR	horizontal capital review
IHC	intermediate holding company
LBO	large banking organization
LFBO	large and foreign banking organization
LIBOR	London Inter-Bank Offer Rate
LISCC	Large Institution Supervision Coordinating Committee
MRA	Matters Requiring Attention
MRIA	Matters Requiring Immediate Attention
NAT	national bank
NMB	state nonmember bank
OCC	Office of the Comptroller of the Currency
PPP	Paycheck Protection Program
PPPLF	Paycheck Protection Program Liquidity Facility
RBO	regional banking organization
ROAA	return on average assets

ROE	return on equity
RRE	residential real estate
SBA	Small Business Administration
SEC	U.S. Securities and Exchange Commission
SHC	securities holding company
SLHC	savings and loan holding company
UDAP	unfair or deceptive acts or practices