

Strategic Planning at the Crossroads:

The Future of Systemic Regulation in the Wake of the Fiscal Crisis, Yellen Confirmation, Market Fragility

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Decision Points

- Reflecting reputational, strategic risk into 2013 stress tests: Must take a qualitative, forward-looking view of possible rules, pending law on line-of-business/enterprise-wide basis
- Must recognize that substantive analytics key to advocacy, especially with new FRB line-up
- Largest BHCs could be regulated as utilities, subject to systemic surcharges, subsidy recaptures, activity-based regulation
- Regional BHCs in never-never land. Strategic opportunities on a line-of-business basis, with greater focus on trading/investment income
- Sum total impact of rules – especially re looming shortfalls of high-quality collateral – not being addressed by Basel, U.S. Serious risk of new incentives for shadow banks, especially in SFT, derivatives/commodity arenas

Issue Forecast

TBTF

- TBTF issue with significant political appeal to “wing-nuts.” Will be on left/right-wing agendas in 2014 mid-term, putting more pressure on the biggest banks
- GAO study critical re regulatory agenda (e.g., inter-affiliate transaction limits), subsidy recapture GAO finding of significant “subsidy” = recapture tax in 2014 and renewed push for Brown-Vitter
- Activity limits (e.g., physical commodities, SFT) to increase. FSB to demand more ring-fencing, pushing FRB to inter-affiliate transaction restrictions in next round of systemic standards
- Greater focus on role of large banks providing credit, serving community

Capital

- Still be-all/end-all of regulatory focus
- Very tough stress tests in 4Q, with emphasis on qualitative planning, board role, operational/legal risk
- Enhanced supplementary leverage rule likely to be finalized with revisions to exposure measurements once QIS on single-counterparty credit limits completed and exposure measurements reconciled. Leverage likely to be backstop, not binding constraint, except where Collins applies. Basel to finalize new leverage rule, although EU implementation at best uncertain.
- Systemic risk-based surcharge to be proposed in next few weeks (absent fiscal meltdown)

Liquidity

- Liquidity NPR to be released in next few weeks (absent fiscal meltdown). Will modify Level1 to reflect agency paper
- Near-term issue is pending FRB daily reporting rules, especially problematic for G-SIBs and FBOs
- Systemic surcharge for US: LCR/NSFR above 100% to mandate new buffer. Will also include strict corporate-governance standards, focus on intraday

Resolution

- FDIC soon to release new policy on SPOE
- FRB soon to propose long-term, unsecured funding requirement to make SPOE work
- Ongoing Chapter 14 work reflected in global discussions, but not near-term reality in U.S. House GOP still wants to repeal Title II, scoring it recently as \$23B savings in fiscal battle
- Example will be made of at least one large BHC based on last set of living wills
- FRB is considering push for repo resolution facility, but odds for this low and separate track of rules (e.g., limits on short-term debt) still under way. Clearing banks face FMU designation for this activity.
- global regulators have proposed insurance, FMU, and asset-management resolution protocols. These have significant bank impact and will be advanced by FSOC once finalized by FSB.

Risk Retention

- Agencies trying to finalize rule by year-end, but hard slog
- Significant dissent to QRM=QM proposal. 90% LTV likely compromise
- Significant changes likely to CLO provisions

Other Issues

- Volcker: May be finalized by year-end, portfolio hedging at risk
- FBOs: Rule likely to be finalized by year-end in tough form
- Shadow Banking: Major focus of global regulators, U.S. However, no consensus on how to handle. EU approach is to limit bank dealing with “shadow” firms – U.S. rules likely to follow suit, with systemic designation for asset managers, other non-banks designed to deal with specific firms. Designations not likely until mid-2014 at the earliest, and FRB will move to curtail bank reliance on MMFs, address other concerns in interim if it fears direct rules on shadows too slow, won't work