



# *FedFin Client Report*

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Thursday, April 19, 2018

## **Quarles Stands by Pending Revisions, Outlines Still More Relief for All but GSIBs**

Client Report: **FEDERALRESERVE45**

### **Executive Summary**

In this report, we assess FRB Vice Chairman Quarles' appearance today before the Senate Banking Committee. It was surprisingly more emotional than the House hearing earlier this week ([see Client Report FEDERALRESERVE44](#)), with Ranking Member Brown (D-OH) calling the eSLR change ([see FSM Report LEVERAGE13](#)) "shameful" in the strongest terms heard from him in recent memory. Sen. Corker (R-TN) was almost as heated, urging that the changes to the SLR for custody banks in the Senate bill ([see Client Report SIFI25](#)) be dropped in conference. Mr. Quarles was also pressed on liquidity relief for non-GSIBs by Sen. Toomey (R-PA); Mr. Quarles said that allowing all but the GSIBs to come under the modified LCR makes sense and indicated that the FRB is working on the specifics of tailoring the LCR pending action on the Senate legislation. Sen. Toomey urged him to move ahead immediately because how and when the bill will proceed is unclear. As noted earlier, FRB Gov. Brainard today took strong exception to changing both the capital and liquidity standards, but Mr. Quarles today indicated that the Fed could go still farther and also raise the threshold for the advanced risk-based capital rules ([see FSM Report CAPITAL201](#)). Doubtless mindful of the "Operation Chokepoint" debacle, Mr. Quarles said that the FRB takes no stand on whether banks should finance guns or related products.

### **Analysis**

#### ***Opening Statements***

Chairman Crapo (R-ID) pushed for expanding the resolution cycle, increasing the transparency of stress tests, differentiating liquidity requirements for GSIBs and non-GSIBs, and raising the advanced approaches threshold. He also applauded efforts to simplify the Volcker rule, define control under the Bank Holding Company Act, and loosen capital requirements on community banks. He urged the Senate to confirm Mr. Quarles for his full term.

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Ranking Member Brown suggested that the Senate bill and Trump Administration are moving the country toward another crisis. He criticized the eSLR rule for benefiting Wells Fargo and as noted called efforts to deregulate the largest banks shameful.

## Testimony

Mr. Quarles' testimony mirrored his testimony from earlier this week.

## Q&A

- SLR: Sens. Brown and Warren (D-MA) blasted the eSLR proposal for both reducing large bank capital and for advancing without the support of the FDIC and Gov. Brainard. Mr. Quarles said estimated capital reductions are small and that the recalibration is necessary to ensure that the risk-based rules are binding. Sen. Warren also asked whether the Senate bill's custody bank provision would apply to other banks that engage in custody services; Mr. Quarles said he does not believe it would apply. As noted, Sen. Corker called for striking this provision from the bill, saying that other Republicans agree.
- LCR: As noted, Sen. Toomey pressed for expanding the modified LCR to all non-GSIBs if their activities warrant; and Mr. Quarles both concurred and said that doing so is an FRB priority. However, he also indicated that the FRB has been delaying action until the legislative outcome is clear.
- Stress Tests: Sen. Brown argued that the FRB's analysis of its proposed stress test revisions ([see FSM Report STRESS29](#)) under-estimates the benefits that GSIBs will receive. Mr. Quarles defended the FRB's analysis. Separately, Mr. Quarles indicated that it is likely that the FRB's stress-test transparency proposals will go farther.
- FBOs: Sen. Brown asked whether the Senate bill will result in the FRB raising the IHC threshold. Mr. Quarles said that the bill does not require this and that very few, if any, FBOs will be effected by a threshold increase. Sen. Brown then asked if this means that the FRB is keeping its options open; Mr. Quarles said that he cannot commit to a final outcome and that no "secret plan" exists.
- Advanced Approaches: Sen. Tillis (R-NC) argued that the advanced approaches threshold should be raised; Mr. Quarles said this is a priority. However, he also indicated that this is an area where the FRB has been deferring action until congressional action is clear.
- CRA: Sen. Menendez (D-NJ) criticized the Treasury's recommendation ([see Client Report CRA20](#)) to allow banks with less than satisfactory CRA ratings to engage in M&A if a community benefit is demonstrated. Mr. Quarles described this recommendation as reasonable. Sen. Jones (D-AL) asked for any modernization to recognize the different characteristic of various communities and not to adopt a universal measurement system.

Mr. Quarles said he could not answer this ahead of the joint proposal but stressed that the goal is to incentivize reinvestment by allowing more activities to receive CRA credit.

- **GSEs:** Sen. Heitkamp (D-ND) suggested that the committee will turn to this after completing its work on the finreg bill. She asked if there is any possibility that Fannie Mae or Freddie Mac could fail or draw funds from Treasury. When pressed, Mr. Quarles said that both are possible. When asked about the risks of the GSEs staying in conservatorship, Mr. Quarles said that certainty is needed with as much of a role for the private sector as possible. Sen. Heitkamp also asked whether a government-backstop is needed for a 30-year fixed-rate mortgage; Mr. Quarles said “probably not” but emphasized that he wants to look at the issue more closely before he says yes or no. Sen. Heitkamp argued many small and mid-sized institutions cannot manage their interest rate risk over thirty years without being able to offload it and Mr. Quarles responded “fair enough.”
- **International Standards:** Sen. Perdue (R-GA) said the U.S. should stop implementing Basel standards until other jurisdictions catch up; Mr. Quarles agreed that the U.S. is ahead of other countries and that other countries need to advance implementation. Sen. Cotton (R-AR) argued that FSB standards should be non-binding and Mr. Quarles agreed.
- **Guns:** Sen. Crapo criticized efforts by New York state regulators to link bank business with the National Rifle Association and the gun industry to increased bank reputational risk. Mr. Quarles said that this business, or lack thereof, does not undermine bank safety and soundness. Sen. Kennedy (R-LA) was highly critical of Citigroup’s and BofA’s new firearms policies and suggested that they may be running afoul of existing FBI background check procedures and anti-age discrimination laws. Mr. Quarles stressed that he does not want to determine bank policy in this area but said that banks must follow existing laws.
- **Compensation:** Sen. Menendez pushed for the FRB to finalize the 2016 interagency incentive-based compensation proposal before it continues to reevaluate other rules. Mr. Quarles said that this remains on the agenda but offered no timeframe.
- **Cybersecurity:** Sen. Reed (D-RI) pressed for advancing the interagency ANPR on cybersecurity ([see FSM Report INFOSEC26](#)) and asked whether Mr. Quarles agrees that bank boards should be required to have one member with cybersecurity expertise. Sen. Jones asked about what regulators are doing globally. Mr. Quarles said that cybersecurity is a top priority. He also said that bank board members with cybersecurity experience are extremely valuable and that regulators are working to promote cyber resiliency.
- **FINRA Margin Rules:** Sen. Cotton argued that FINRA’s new margin requirements for to be announced securities create an un-level playing field because the rule applies to broker-dealers but not to banks. As a result, certain broker-dealers can use their banking arms to evade requirements. He asked for the FRB to review the rule before it becomes effective; Mr. Quarles agreed to do so.