



FedFin Client Report

Tuesday, November 15, 2022

Crypto, Deposit Rates, Capital Top Senate Discussion

Client Report: REFORM214

Executive Summary

At today's Senate Banking oversight hearing with the banking agencies, Chairman Brown (D-OH) generally applauded the work of regulators, emphasizing the need for tough standards, like-kind rules for bigtech companies, and an inquiry into why depositor interest rates lag Fed rate hikes along lines [posed](#) earlier by Sen. Reed (D-RI). FDIC Acting Chairman Gruenberg concurred, criticizing banks for sluggish rates. Ranking Member Toomey (R-PA) reiterated his longstanding complaints about regulators straying outside their mission in areas such as climate change. He also called for SLR relief to reduce Treasury-market risk and opposed pending large-bank resolution guidance ([see FSM Report LIVINGWILL19](#)) on grounds that it is unnecessary. FRB Vice Chairman Barr detailed the facets of capital regulation that will go into his "holistic" review but provided no timeframe for this or the Basel "end-game" standards other than that progress will be clearer in the first quarter of next year. Neither he nor the other agency heads provided any insight into when the inter-agency merger review will be completed. Discussion raged over FTX and the need for crypto finance regulation without any indication that senators are ready to undertake federal statutory change even with regard to stablecoins. Despite Republican complaints about various FDIC actions, only Senator Tillis (R-NC) stated that he opposes Acting Chairman Gruenberg's nomination.

Analysis

Opening Statements

Chairman Brown approvingly highlighted regulatory efforts to protect financial stability and promote fairness, such as the CRA rewrite ([see FSM Report CRA32](#)), work on overdraft fees, the merger process review, and superregional resolution. He also warned of the risks of climate change, shadow banks, and geopolitical threats and stressed that fintechs cannot be allowed to play by different rules than traditional banks. Ranking Member Toomey framed his statement around the politicization of banking regulations, denouncing the Fed's climate [pilot](#), accusing the agencies of allocating capital from carbon intensive industries, and questioning the need for new resolvability guidelines for regional banks. He also argued that lack regulatory clarity for stablecoins has forced firms overseas and that a lack of action addressing deteriorating liquidity in Treasury markets may force the Fed to procyclically resume bond

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Testimony

Vice Chair Barr emphasized that the Fed's supervisory priorities are promoting safety and fairness, highlighting its reviews of capital requirements, monitoring of crypto risks, and its upcoming pilot climate scenario. He noted concerns regarding market concentration in mergers but provided no insight into the long-delayed merger policy update ([see FSM Report MERGER10](#)). NCUA Chairman Harper noted the Administration's efforts to strengthen capital, cybersecurity, and support small and minority credit unions. Acting Chairman Gruenberg reviewed the state of the industry, arguing for its general soundness amid economic and geopolitical uncertainty. He also noted that the FDIC will be monitoring risks from interest rate increases, inflation, macroeconomic uncertainty, and changes in geopolitics. Acting Comptroller Hsu stressed the need for banks to better serve their communities.

Q&A

- **Financial Stability:** Chairman Brown and Sen. Ossof (D-GA) asked the regulators the biggest threats to financial stability. The four listed interest rate and liquidity risk, cybersecurity, credit risk as the economy softens, exposure to commercial real estate and housing markets, geopolitical destabilizers in Ukraine and China, climate related risks, and a lack of visibility into nonbank finance.
- **Crypto Custody Assets:** Ranking Member Toomey argued that the recent FTX collapse demonstrates that the problem with digital assets is how actors misuse them, not the assets themselves. Thus, he asked Acting Comptroller Hsu to verify if the OCC discourages banks from engaging in crypto-related activities; Mr. Hsu replied that crypto custody services need to be treated differently as some fundamental issues such as verification of ownership have not been addressed. The Acting Comptroller stated that the OCC will approve of crypto activities if the bank can prove that it can do so safely.
- **Crypto Interconnectedness:** Sen. Lummis (R-WY) claimed that her stablecoin bill ([see FSM Report CRYPTO28](#)) would have mitigated or even prevented the FTX collapse, as it requires proof of reserves and imposes affiliate transaction restrictions similar to banks, highlighting Wyoming's "tough" digital asset rules as a model for the Fed. The Senator asked Mr. Barr on how BHC inter-affiliate rules would have affected the FTX collapse; he stressed that they are foundational to banking law.
- **Crypto Regulation:** Sen. Van Hollen (D-MD) asked all four regulators if crypto should be regulated, worrying that it may lead some to falsely believe that the assets are safe. Mr. Hsu replied that it depends on the details of the regulation, while the remaining three

argued that some form of new regulation is needed. However, Vice Chair Barr and Acting Chairman Gruenberg also insisted that the banking agencies had the necessary authorities in the banking sector.

- **Deposit Rates:** Under questioning from Sen. Reed, Acting Chairman Gruenberg stated that banks are clearly trying to take advantage of increasing interest rates in credit products, but lag in raising interest on savings, hoping that competitive pressures will force a change.
- **Regulatory Capital:** Sen. Rounds (R-SD) asked for an update on the Fed's holistic capital review; Mr. Barr stated that the Fed can provide clearer updates in the first quarter next year. Sens. Tillis and Hagerty (R-TN) asked the Vice Chair whether a capital requirement increase would be procyclical if a recession occurs; he stated that the Fed is reviewing the impact of capital requirements through the business cycle.
- **Treasury Liquidity:** Sen. Ossof asked if Vice Chair Barr is as worried as Secretary Yellen about Treasury market liquidity; the Vice Chair noted that the Fed has noted high volatility causing decreased liquidity in Treasury markets but refused to describe it as worrisome.
- **Climate:** Sen. Smith asked the regulators about industry reception to upcoming climate guidance; Mr. Gruenberg and Mr. Hsu stated that the industry, especially larger banks, has been largely receptive, but Mr. Hsu added that responses from community banks have been more varied.
- **Federal Reserve Bank President Process:** Sen. Menendez (D-NJ) reiterated complaints about a lack of transparency and diversity in the selection process of Reserve Bank Presidents ([see Client Report FEDERALRESERVE67](#)), asking the Vice Chair for an update on the Fed's progress. Mr. Barr stated that some positive steps have been made on public position postings, but more is needed regarding publicly releasing demographic information and gathering public input.
- **Volcker Rule Divestment Delays:** Sen. Reed asked Vice Chair Barr whether there would be any further delays in requiring banks to divest from hedge funds as required by the Volcker Rule; he replied that there would not be and that the Fed will be firmer in enforcing this requirement.
- **Fintech Partnerships:** Sen. Reed also asked what the FDIC is doing to address fintech partnerships; Acting Chairman Gruenberg stated that, from a supervisory standpoint, the FDIC treats third party services as if they are offered by the bank and that it is looking into lending activities to ensure they are properly underwritten and transparent.

- **SIFI Designation:** Sen. Van Hollen asked that if Secretary Yellen wanted to repeal the 2019 SIFI standards, whether the present FSOC members would support that initiative; all replied that they would.
- **FHLB Member Waivers:** Sen. Moran (R-KS) argued that capital rules for FHLB members should be realigned instead of requiring them to get written waivers from their regulators for FHLB loans. Acting Chairman Gruenberg replied that is an issue for the FHFA but clarified that this policy addresses risk management and committed to working with the FHFA to determine its necessity.
- **FedNow:** Sen. Van Hollen asked the Vice Chair for an update on the implementation of FedNow; Mr. Barr stated that, while roll-out is planned for May to July of next year, it will take time for banks to properly implement and realize its benefits.
- **DIF:** Sen. Rounds asked Acting Chairman Gruenberg how the FDIC decided on a 2bp hike, especially given that the OCC lowered assessments for community banks; Mr. Gruenberg explained that the move ([see FSM Report DEPOSITINSURANCE116](#)) avoided the possibility of a procyclical hike in the future should the economy continue to slow.