



FedFin Client Report

Wednesday, November 16, 2022

HFSC Session Brings Crypto Action to Fore, “Holistic” Capital Under Scrutiny

Client Report: REFORM215

Executive Summary

HFSC today largely focused bank regulators on the same range of questions posed at yesterday’s Senate Banking session ([see Client Report REFORM214](#)). However, Chairwoman Waters (D-CA) emphasized the importance of federal legislation in sharp contrast to Chairman Brown (D-OH), also [announcing](#) a hearing in December on FTX. Ranking Member McHenry (R-NC), who will become HFSC chairman in the next Congress, concurred with the chairwoman’s views on the need for digital-finance statutory reform. However, he took strong issue with inter-agency policy with regard to new capital rules, merger restrictions, and third-party relationship constraints. Republican members also targeted Vice Chairman Barr’s [holistic capital review](#), arguing that banks are currently well capitalized and that additional standards would hamper lending. Mr. Barr indicated that an SLR rewrite is part of the holistic review but not immediately necessary to quell Treasury-market volatility or illiquidity. As discussed in more detail below, regulators promised banking-sector crypto rules at least as stringent as Basel’s proposal.

Analysis

Opening Statements

Chairwoman Waters praised the agency heads for recent work on CRA and bank mergers, reiterating her call that hearings be held before a more stringent approval process begins. She asked if Congress should pass legislation in the digital asset space, especially regarding stablecoins. In addition to the comments above, Ranking Member McHenry called FTX’s collapse a “dumpster fire,” calling again for a congressional digital asset regulatory framework that includes trading platforms.

Testimony

Testimony was the same as provided at yesterday’s Senate Banking session.

Federal Financial Analytics, Inc.
2101 L Street, NW – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com

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Q&A

- **Crypto Regulation:** Chairwoman Waters largely confined her comments to this topic, asking Vice Chair Barr a string of questions including whether he supports what he knows of the pending stablecoin approach. Mr. Barr affirmed the urgent need for crypto legislation, emphasizing the particular financial stability and run risks posed by private money. Chairwoman Waters also asked Acting Comptroller Hsu whether digital asset wallets should be allowed to comingle funds of consumers and, if such assets are comingled, if they can be used to lend customer assets for other purposes. Mr. Hsu said they shouldn't, arguing that traditional financial rules preventing this activity should extend to crypto. Reps. Maloney (D-NY), Velazquez (D-NY), Perlmutter (D-CO), Vargas (D-CA) also fielded questions around crypto regulation, with Mr. Barr repeatedly calling on Congress to strengthen oversight of the sector. Rep. Sherman (D-CA) asked the banking regulators if they would commit to crypto standards at least as stringent as those proposed by the Basel Committee ([see FSM Report CRYPTO34](#)); all four affirmed that they would. Rep. Huizenga (R-MI) asked Vice Chairman Barr whether the Fed is coordinating with the SEC and CFTC on digital asset work; Mr. Barr said the regular contact with these agencies takes place through FSOC.
- **Stablecoins:** Rep. Gottheimer (D-NJ) asked Vice Chairman Barr how the Fed would develop a supervisory framework if given oversight of stablecoins issued by banks and nonbanks; Mr. Barr emphasized the need for strong guardrails and prudential oversight. Rep. Gottheimer also asked Acting Chairman Gruenberg if creating an insurance fund for stablecoins would be useful if issuers regularly prove they are fully backed by cash and cash equivalents; Mr. Gruenberg said that he will look at this carefully, but emphasized that deposit insurance is a separate question.
- **Capital Requirements:** Multiple Republican Congressman, including Luetkemeyer (R-MO), Wagner (R-MO), Barr (R-KY), and Steil (R-WI) questioned Vice Chairman Barr over why capital requirements should be strengthened despite strong financial system capitalization. Mr. Barr defended the importance of capital requirements for banking system resiliency, saying he is looking at holistic capital requirements in terms of what the right amount of capital in the banking system is over the long term and that any notice on capital requirements would go through full rulemaking process.
- **TLAC:** Rep. Foster (D-IL) asked for Vice Chair Barr's view on contingent capital requirements and whether these will be looked at as part of the holistic review; Mr. Barr stressed that a form of these instruments already exists as gone-concern capital, opining also that caution with CoCas is necessary because they can accelerate run risk as buffers are approached. Mr. Barr defended his preference for a gone concern version of the instrument because he said they are only triggered on resolution and do not carry the same contagion potential and retain an absorbing mechanism.

- **Treasury Market Liquidity:** Ranking Member McHenry largely focused his questions on this topic, asking Vice Chairman Barr if bank treasury market concerns are valid and what is being done to address them. Mr. Barr emphasized that treasury market resiliency is being analyzed as part of a broader interagency review, noting the Fed’s backstop for repo transactions and foreign-official repo transactions. Ranking Member McHenry said the Fed has a large remit to address capital standards and asked if they have bearing on liquidity in the Treasury marketplace; Mr. Barr said this ranks relatively low on the list of reasons for treasury market liquidity constraints and thus that it is not a high priority within the capital-framework review. Rep. Wagner (R-MO) brought up Gov. Bowman’s recent [speech](#) regarding banking system reserves and capital distribution and asked Vice Chairman Barr if he agreed that addressing these issues with leverage ratios can improve market functioning and financial stability; Mr. Barr said he had not seen Gov. Bowman’s remarks, but that the treasury market is resilient and robust.
- **SLR:** Ranking Member McHenry asked Vice Chair Barr if increased capital requirements on banks like the SLR has impacted the ability of banks to facilitate treasury market liquidity; Mr. Barr, noting his holistic framework, said he is looking at how an enhanced SLR and other capital requirements would work together. Asked later by Rep. Sherman if enough is being done to adjust leverage requirements to incentivize more treasury market intermediation, Mr. Barr reaffirmed that a revised version of the enhanced SLR is under consideration.
- **CCPs:** Rep. Lucas (R-OK) asked Acting Chairman Gruenberg what financial regulators should be focused on with regard to CCPs and whether the FDIC has engaged with the CFTC and SEC. Mr. Gruenberg said that supervision of CCPs is a critical priority and that a capacity to strengthen supervision and manage orderly failures is needed.
- **Climate:** Several Republicans including Lucas (R-OK), Barr, Williams (R-TX), and Mooney (R-WV) questioned the banking regulators about whether their agencies had climate regulatory expertise, with several also voicing concern over the Fed’s new climate pilot program and whether this would carry supervisory implications or spur capital requirements; Mr. Barr emphasized that it does not and it won’t, that the Fed’s role in this area is narrow and that it will not direct bank lending. Rep. Casten (D-IL) asked Mr. Barr if he agrees that ignoring climate risk puts the public at risk and whether this represents breach of banks’ fiduciary duty; Mr. Barr stressed the importance of financial institutions upholding safety and soundness standards in serving customers.
- **Fintech Partnerships:** Rep. Davidson (R-OH) asked Acting Chairman Gruenberg about the FDIC’s fintech activity and specifically what is being done to address what he called the slowdown at FDI Tech. Mr. Gruenberg said the FDIC has a group dedicated to a forward-looking approach to how technology can be applied to banking regulation. Rep. Steil also asked the Acting Chairman about how the FDIC is streamlining compliance for

Fintech service companies; Mr. Gruenberg said that management of third-party relationships is a core risk management issue.

- **CRA:** Chairwoman Waters praised the agencies for rejecting the Trump era-rule she said would have undermined the CRA. Several Democrats, including Reps. Cleaver (D-TX), Meeks (D-NY), Lawson (D-FL), and Pressley (D-MA) also asked for insight into whether the proposed CRA rule should include communities of color in bank assessment areas and whether legal violations would factor into ratings. The banking regulators affirmed that the CRA should take discriminatory practices into account.