FedFin Daily Briefing

Thursday, March 16, 2023

FedFin Assessment: One CS Consequence – LISCC Reinstatement For All Large Foreign GSIBs

In the wake of CS's distress, we draw client attention to a 2021 exchange sure to factor heavily in the political response. As detailed in FedFin Report REFORM206, Sen. Warren (D-MA) had a very caustic exchange in 2021 with then-Fed supervisory Vice Chair Quarles related to Archegos' losses. She argued that the Fed had ample knowledge of CS's vulnerabilities because it had failed the 2019 stress test and that it and other foreign GSIBs operating in the U.S. should have remained on the Large Institution Supervisory Coordinating Committee (LISCC). Mr. Quarles countered that CS's Archegos's losses, while material, were largely outside the U.S., noting further that these offshore losses had no U.S. implications. Sen. Warren scoffed at this and will surely renew her assertions that GSIB offshore losses do indeed have U.S. consequences that warrant far more stringent U.S. supervision. We would at the least expect the Fed now to reconsider LISCC membership and likely reinstate it for large GSIBs. Forthcoming FedFin reports will also assess the prospects for new U.S. liquidity rules and greater foreign-branch ring-fencing.

Brown Presses For In-Depth SVB, Signature Review

As anticipated (see *Client Report* **RESOLVE49**), Senate Banking Chairman Brown (D-OH) today called on all the banking agencies and Treasury quickly to undertake a review of SVB and Signatures failures. Unlike Sen. Warren (D-MA), he does not criticize the independent review now under way at the Fed, instead asking all the agencies to look at the scope of uninsured deposits at these banks and – an issue also for HFSC Chairman McHenry (R-NC) – the role social media played in last week's runs. He also asks for analysis of regulatory – and apparently not also supervisory – failures that led to the bank as well as appropriate remedies. He also notes that the FDIC will in due course assess its resolutions but asks it to do so more quickly in order to understand any necessary new guardrails. No deadline for an answer for the investigations is set.

Warren Heaps Still More Blame On Powell

In another letter today, Sen. Warren (D-MA) once again lambasted Chair Powell for what she claimed was his direct contribution to the collapse of Signature Bank and SVB as well as a "a culture of corruption" at the Fed. In addition to calling for action on her bill to repeal Trump-era Dodd-Frank "rollbacks" and putting blame firmly on the Chairman for supporting the law at the time, the letter lists several FRB deregulatory actions initiated under Mr. Powell that the senator claims weakened banking system oversight. It also censures the Chairman and the Fed more broadly for "egregious" ethics violations, noting conflicts of interest stemming from SVB CEO Gregory Becker's contemporaneous tenure on the FRB-SF board and alleged improper trading activity by several board members. She concludes by reiterating calls for the Chairman to recuse himself from the Fed's internal review of SVB and demands answers on his actions related to S. 2155 in 2018 by March 29.

Senate GOP Blames Fed, California re SVB

Senate Banking Republicans today tweeted a series of comments citing articles going back to last year identifying SVB risk and suggesting strongly that the Fed and California state supervisors are at fault for missing clear warning signs. Sen. Scott (R-SC) also asks whistleblowers to come forward to describe these lapses. As anticipated (see *Client Report* **RESOLVE49**), this is further evidence that the GOP will press hard on supervisory lapses to counter Democratic demands – see again just earlier today – for new rules and/or law.

Bipartisan Senators Push Better Beneficial-Ownership Data Access

Senate Budget Committee Chairman Whitehouse (D-RI) was joined by Sens. Wyden (D-OR), Warren (D-MA), Grassley (R-IA), and Rubio (R-FL) late yesterday in submitting a comment letter to FinCEN taking serious issue with its proposed implementation of the Corporate Transparency Act (CTA) (see FSM Report **AML135**). The bipartisan comment differs sharply with one sent by HFSC Republicans, arguing that the proposed rule strays from congressional intent and creates costly barriers to accessing FinCEN's beneficial-ownership registry, an objection shared in many financial-industry comments. The letter asks FinCEN to remove numerous requirements impeding access by law enforcement, GAO, and financial institutions, also asking that the agency establish an automated process for fielding and responding to financial institution access requests. Further, they ask FinCEN to clarify that financial institutions are not expected to affirmatively obtain new consent from an existing reporting company customer each time they need to query the directory.

Senate Finance Hearing Deepens SVB Divide

At a heated Senate Finance hearing with Treasury Secretary Yellen, Members were quick to deviate from the hearing's budget-focused agenda to address who should bear the blame for SVB's collapse. Senate Banking Ranking Member Scott (R-SC) and other Republicans blamed regulators for failing to identify SVB's risky behavior and Ranking Member Crapo (R-ID) voiced concern about the moral hazard created from protecting uninsured deposits. Sen. Lankford (R-OK) took the issue a step further, arguing that the move fuels depositor flight from community banks to large banks. Continuing to press the issue, Sen. Blackburn (R-TN) asked the Secretary if protecting uninsured deposits signaled a step towards nationalizing the banking system, which Ms. Yellen strongly denied. Interestingly, Sens. Warner (D-VA) and Bennet (D-CO) joined their Republican colleagues in questioning why supervision did not catch SVB's woes, with Mr. Warner also demanding consequences for bad actors who may have taken advantage of social media. Senate Banking Chairman Brown (D-OH) and other Democrats, however, continued to praise the banking agencies' actions and reiterated the President's call to repeal the 2018 deregulatory law. Sen. Warren (D-MA) again attacked Chairman Powell, also arguing that Congress unwisely enabled him to slash banking rules. When asked by Sen. Hassam (D-NH) by which metrics Treasury would be evaluating the banking agencies' decisions, the Secretary replied she will be looking for stress in the banking system, symptoms of contagion, and the cost and availability of credit.

Hagerty Presses Demands re SVB-Resolution Review

Building on his prior comments, Senate Banking Member Hagerty (R-TN) today sent a letter to the FDIC's IG urging him to investigate the agency's compliance with the least-cost resolution statute in its resolution of SVB. The senator takes specific issue with the FDIC's application of the systemic risk exception in SVB's case, arguing that the agency's employees may have intentionally averted lower-cost options and that the bidding process for potential buyers was inexplicably delayed. He also claims that the FDIC's decision to support uninsured depositors through a special bank assessment will not only be passed on to bank customers, but also serve as an implicit commitment that the agency will always back uninsured deposits. No response deadline is set.

First Republic Pulled From Frying Pan

After days of frantic negotiations, Treasury and the banking agencies have announced that a banking consortium deposited $30 billion in First Republic Bank. The statement says nothing more, taking no stand on the extent to which the government played a role in this action nor naming any of the banks. These are, however, named in a statement from the institutions, which as expected comprise mostly the nation's largest banks which interestingly contributed varying amounts. Although press is referring to this as "capital", the use of deposits rather than any form of investment was surely chosen to avoid any suggestion that any large bank or this consortium was given any form of control over First Republic Bank amounting to a back-door acquisition sure to spark anti-consolidation concerns. It also ensures that none of the banks takes a controlling interest in the bank and thus the resulting capital and governance obligations. In the event First Republic were to fail, these banks would be at risk if the FDIC or federal government more broadly did not extend coverage to uninsured depositors as was the case with SVB and SBNY. Indeed, this structure is likely chosen to create a risk buffer of uninsured deposits permitting a more traditional resolution should that still be needed because each of the banks is able to bear its loss and remaining uninsured depositors do not pose the systemic or macroeconomic risk feared from SVB and SBNY. That said, any failure with risk to uninsured depositors could start renewed panic runs, with the hope surely that the new deposits give First Republic the liquidity to avoid asset dispositions that threaten its solvency.

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Community Bank Deposit-Insurance Campaign Notches First Bill Introduction

Responding to demands from community banks, Sens. Hawley (R-MO) and Braun (R-IN) introduced legislation that bars banks from passing on the cost of special assessments to consumers and prevents the FDIC from levying special assessments on community banks to protect uninsured depositors, as it recently did with SVB and Signature Bank. The measure also allows for the FDIC to seize bonuses earned by the executives of failed banks. As noted (see *Client Report* **DEPOSITINSURANCE118**), we expect legislation among these lines to advance to the community banks' lobbying clout, but this GOP bill will not be the vehicle for final action.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **DEPOSITINSURANCE118:** As promised in our first post-SVB impact assessment (see *Client Report* **RESOLVE49**), this report begins a series of analyses of specific policy issues.
- **RESOLVE49:** As we noted last night, the President concurred with Treasury, the Fed, and FDIC in deciding that SVB's Friday failure and imminent runs on Signature Bank and, most likely, others posed a systemic risk.
- **GSE-030923:** As detailed in our reports earlier this week on Powell's appearance before Senate Banking and HFSC, much was said about the pending rewrite of big-bank capital standards.
- **FEDERALRESERVE73:** At today's HFSC hearing, Chairman Powell modulated his hawkish stance just a bit, continuing as he long has done to refuse to take a stand on fiscal policy while advocating for rapid debt-limit action.
- **FEDERALRESERVE72:** Although Chairman Powell's testimony kept exclusively to monetary policy, today's Senate Banking hearing seemed only to go through the motions set at previous hearings with regard to inflation, growth, and the Fed's long-term objectives.
- **GSE-030123:** A recent FRB-Atlanta study finds that closing the racial homeownership gap alone would not redress housing market racial disparities because minority homeowners cannot equitably access home equity and thus enjoy comparable access to the economic opportunities afforded by homeownership.
- **SANCTION20:** In a remarkably bipartisan session, the Senate Banking Committee today made it clear that Congress wants tougher sanctions against Russia, near-term action against hold-out nations to oil-price caps and other efforts, and perhaps even confiscation of Russian assets to fund U.S. Ukraine aid.
- **CRYPTO40:** In the wake of revelations by Silvergate and other banks about significant deposit exposures to cryptoasset entities, federal banking agencies have issued a statement about the need to

manage liquidity risk associated with cryptoassets.

- **GSE-022723:** FHFA has proposed a set of refinements to the current GSE capital construct.
- **CUSTODY5:** Making full use of powers granted in the 2010 Dodd-Frank Act, the SEC is proposing a wholesale rewrite of the rules dictating how investment advisers must place assets in custody and which institutions are considered qualified for this purpose.
- **GSE-022123:** As we noted, FHFA is venturing onto treacherous political ground with a request for input on expanding Fannie and Freddie's ESG imprint.

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