



FedFin Client Report

Wednesday, March 29, 2022

HFSC Focuses on Supervision, Clawbacks, Process, New Resolution and Run-Risk Options

Client Report: REFORM218

Executive Summary

Today's HFSC hearing on recent bank failures was more partisan than yesterday's Senate Banking session ([see Client Report REFORM217](#)). Still, there were significant areas of agreement evidenced not only through the marathon hearing, but also at its end, when Chairman McHenry (R-NC) and Ranking Member Waters (D-CA) agreed that they are frustrated with the regulators' testimony, want more supervisory accountability, and will demand reforms once promised internal investigations are concluded. Several new issues were brought out today, including why the FedWire closing times precluded liquidity support that might have sustained SVB liquidity, whether TLAC should be required at banks of all sizes, tactics to quell viral runs, and whether tough new rules will cover mid-sized banks and/or community institutions. Vice Chairman Barr confirmed that the capital and liquidity revisions he plans may cover Categories 3 and 4 under the current tailoring rule ([see FSM Report SIFI34](#)), but community banks will not be subject to higher capital requirements. FDIC Chairman Gruenberg reiterated that special assessments may not cover community banks. Today's session also focused on intervention timelines and the extent to which the agencies will share confidential supervisory data with Congress. As detailed in this report, Members on both sides of the aisle pointed to numerous supervisory concerns and demanded an array of reforms. Rep. Brad Sherman (D-CA) also requested a list of banks with large HTM holdings and current capital ratios below five percent; Mr. Gruenberg promised a review that would not name individual banking organizations.

Analysis

Opening Statements

Chairman McHenry is open to changes to laws or regulation, but emphasized the need first to establish the facts. He was also sharply critical of what he characterized as Vice Chair Barr's prioritization of climate review for larger banks at the expense of liquidity provisions. The Chairman also suggested that an ideological lens may have colored the regulators' systemic risk decision and criticized FSOC for transparency failures. Ranking Member Waters' opening statement reiterated yesterday's Democratic blame on bank mismanagement and the

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“deregulatory” law passed under the Trump administration. She also repeated calls to enhance executive compensation clawbacks, taking strong issue with what she believes to be a racist overtone in GOP commentary regarding SVB. Rep. Hill (R-AR) focused on series of [letters](#) sent to regulators last week, making clear he expects their full cooperation with an investigation he promised would be robust. Rep. Foster (D-IL) argued that changes in digital technology enabling faster bank runs such as that suffered by SVB requires stronger emergency liquidity provisions that should be available at all times, also arguing that liquidity providers should have a clear and simple means of knowing counterparties will remain solvent. He also focused on contingent capital, arguing that – had U.S. regulators prioritized this requirement – SVB could have been resolved without utilizing the DIF.

Testimony

All of today’s testimony was the same as yesterday.

Q&A

- **Holistic Capital Review:** Chairman McHenry and Reps. Wagner (R-MO) and Meuser (R-PA) voiced concerned about the lack of transparency behind Vice Chair Barr’s holistic capital review and asked if the review implies that the banking system is undercapitalized. Mr. Powell reiterated that he believes banks are well-capitalized and reassured members that Mr. Barr’s review was typical of incoming Vice Chairs of Supervision and that any formal proposals to evaluate capital will be transparent and open to comment. Reps. Wagner and Williams (R-TX) also argued that raising capital requirements will limit lending; Mr. Powell emphasized the need to balance capital and growth and reiterated that there are no formal proposals. Rep. Barr (R-KY) asked the Chairman to commit not to implement capital changes or Basel endgame standards while there is considerable Board dissent. Mr. Powell did not commit but emphasized that he will do the most he can to build consensus. Rep. Scott (D-GA) asked Chairman Powell to clarify rumors that the banking agencies are looking to apply G-SIB capital rules to D-SIBs; Mr. Powell denied this.
- **Supervisory Lapses:** Marking his clear concern over regulators’ reasoning for invoking the systemic risk exception, Chairman McHenry grilled each of the witnesses on the timeline of SVB’s distress and when they knew of it, promising further investigation and focusing on provisions to make the discount window available and on when the FDIC’s auction was initiated. Ms. Waters asked Vice Chair Barr what SVB’s liquidity rating was; Mr. Barr said it was 2 and that the Fed’s review will look at whether liquidity standards were stringent enough and if further supervisory steps are necessary. She also asked Mr. Barr if the Fed failed in supervising the bank; Mr. Barr said that it was clear that there were failures in bank management, regulation, and supervision. Vice Chair Barr also said he expects the Fed’s review to find that supervisors should have put mitigants in place more promptly. Several Republicans also argued that regulatory preoccupation with ESG and DEI clouded supervisory judgment; in a later exchange with Rep. Garcia (D-TX), each

regulator pushed back on that assessment. Rep. Davidson (R-OH) argued that HTM spread risk should be included in the Fed's liquidity supervision; Vice Chair Barr said this is part of the Fed's review, while Chairman Gruenberg acknowledged the significance of this risk. Rep. Velázquez (D-NY) asked Vice Chair Barr if category 3 and 4 banks face the same rules as megabanks; Mr. Barr defended tailoring but reiterated that stronger capital and liquidity rules are needed. Reps. Barr and Davidson argued that existing tailoring rules give the Fed all the tools it needs; Mr. Barr again acknowledged that the Fed had ample discretion to implement prudential oversight for banks larger than \$100 billion.

- **Run Risk:** Reps. Lynch (D-MA) and Gottheimer (R-NJ) asked Chairman Gruenberg and Under Secretary Liang if more needs to be done to address the risks of high-speed depositor flights; Each acknowledged the importance of this issue, and they are focused on it. Rep. Himes (D-CT) suggested that automatic mechanisms should be put in place. Chairman McHenry requested written responses. Rep. Himes also asked Vice Chair Barr if mandatory action should follow a deficiency rating; Vice Chair Barr agreed this is something that should be reviewed both by regulators and by Congress, noting that risk mitigants should be in place that can be quickly ordered by supervisors.
- **Short Sales:** Rep. Luetkemeyer (R-MO) raised concern over short sales on distressed banks; Mr. Barr noted that the review will examine this critical issue.
- **Regulatory Limits:** Republican Members countered calls to give new authorities to the regulators, arguing that they inadequately enforce existing rules. Rep. Vargas (D-CA) asked Chairman Gruenberg what prudential regulations need to be reviewed; Mr. Gruenberg said regulators should start with supervision, particularly of liquidity risk, and that in light of the SVB episode, the prudential framework for regional banks should be re-examined.
- **Statutory Rewrite:** Ranking Member Waters asked Vice Chair Barr if he would suggest a legislative rewrite; Mr. Barr said the Fed's review will focus on internal issues.
- **Systemic Risk Exception:** Rep. Lucas (R-OK) asked Vice Chair Barr about systemic risk exception; Mr. Barr promised to do so in writing. Reps. Loudermilk (R-GA), Rose (R-TN), and Meuser asked Under Secretary Liang to clarify the Department's position on deposit insurance; Ms. Liang reiterated Secretary Yellen's comments that Treasury will use its tools as needed to protect the financial system, noting that this also applies to smaller institutions posing contagion risk. Reps. Loudermilk and Timmons (R-SC) said they were concerned that the systemic risk exception created moral hazard across the banking system; Ms. Liang acknowledged that Treasury will need to address moral hazard. Mr. Loudermilk Under Secretary Lian if Treasury is concerned about moral hazard stemming from decision; the Under Secretary stated that Treasury's concern is focused on the current situation.
- **Monetary/Regulatory Policy Coordination:** Rep. Velázquez asked Vice Chair Barr if the Fed's regulation and supervision is separate from monetary policy; Mr. Barr said that the Fed's monetary policy is well telegraphed, noting again that SVB's failure to address interest rate risk was a basic management failure. Rep. Velázquez also asked Vice Chair Barr how the Fed will balance its supervisory role as it considers future interest rate

increases; Mr. Barr emphasized that the Fed has all the micro- and macro prudential tools it needs to handle these risks.

- **Special Assessment:** Reps. Barr, Williams, Lucas, and Meuser asked Chairman Gruenberg if he would commit to using the FDIC's authority to establish separate risk-based assessment systems for large and small members of the DIF so that "well-managed" banks do not have to bail out mismanaged ones; Mr. Gruenberg said he would consider this, noting the FDIC's comprehensive review of the deposit insurance system and that the Board will be "keenly sensitive" to the impact on community banks.
- **Deposit-Insurance Ceiling:** Rep. Beatty (D-OH) asked Chairman Gruenberg for his thoughts on proposals to increase the deposit insurance threshold and to limit it for the largest financial institutions; Mr. Gruenberg explained that this number is set by statute and noted that the FDIC's report will address this. Rep. Davidson suggested that the private insurance market used by some credit unions may be appropriate for protecting deposits.
- **Contingent Capital:** Building on his opening statement, Rep. Foster argued that Credit Suisse's recent collapse did not cost the Swiss taxpayers anything because of Swiss contingent capital requirements. Vice Chair Barr responded by stating that he will discuss this further.
- **FDIC Resolution Process:** Rep. Hill asked Chairman Gruenberg if he would look at revising the resolution process and work with Republicans to do so; Mr. Gruenberg said he was and that he would. Rep. Hill also asked if nonbank buyers for failed bank assets should be considered; Mr. Gruenberg agreed that should be done. Rep. Rose asked Chairman Gruenberg why the FDIC capped its "stock" (i.e., equity appreciation rights) in First Citizens' Bank following the sale of SVB at \$500 million, with Mr. Gruenberg stating that this was a matter of negotiation. Mr. Rose then asked if the White House pressured the FDIC not to accept bids from large banks; Mr. Gruenberg said it did not.
- **Digital Assets:** Rep. Emmer (R-MN) asked if the company that bought Signature's payment system Signet would be able to facilitate 24/7 access to the banking system for digital asset companies. Chairman Gruenberg will follow up. Mr. Emmer then asked if the FDIC would block the purchasing bank from serving digital asset companies; Mr. Gruenberg stated that, if that was the nature of the purchase, he would not. Mr. Emmer also asked if the FDIC has ever indicated that a bank's supervision would be more onerous if they onboarded new digital asset clients, citing Flagstar's of SVB's digital asset company deposits at Signature; Mr. Gruenberg replied the FDIC had not.
- **CRE Risk:** Rep. Torres (D-NY) asked Chairman Gruenberg if the FDIC was concerned about the declining value of commercial real estate portfolios; Mr. Gruenberg said it was an issue the FDIC was tracking.