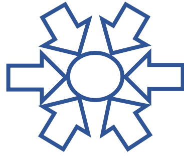

FedFin Daily Briefing

Friday, April 28, 2023

GAO Slams Fed, FDIC

Laying out a counter-story if the FRB and/or FDIC reports later today are self-exculpatory, the GAO this morning released its preliminary assessment of the SVB and SBNY failures. In short, it places blame squarely on the agencies for ignoring how fast the banks grew without adequate risk-management capabilities. GAO also notes that the agencies should have been on guard because of the banks' reliance on uninsured deposits and how unstable these can prove, with both the Fed and FDIC spotting problems at least five years ago but doing nothing in a timely way to force remediation. The Federal Reserve Bank of San Francisco downgraded SVB, but only filed an enforcement action the day before the bank failed; the FDIC observed many deficiencies, but failed even to downgrade Signature until the day before it failed. GAO recommends, as Karen Petrou did in 2001 testimony, that the banking agencies add non-capital triggers to their prompt corrective action protocols. We will shortly provide clients with an in-depth analysis of GAO's report in concert with detailed analyses of those from the Fed and FDIC.

FSOC Sets Deadline For Systemic, Nonbank Activity Proposals

The *Federal Register* today includes the framework proposed at FSOC's meeting last week outlining an analytical approach to identifying and addressing systemic risks. As previously noted (see FSM Report **SYSTEMIC95**), the proposal expands on the criteria for systemic intervention, differing from the Fed's criteria used to designate GSIBs and thus creating the possibility of SIFI designation for smaller banks. The new framework in part focuses on interconnections and risk transmissions, also creating the prospect of systemic designations achieved through new bank rules rather than attempts to directly govern nonbank sectors. Comment is due by June 27, the same deadline for comments on the nonbank SIFI-designation construct analyzed in a forthcoming FedFin report.

Fed SVB Post Mortem: Now We Need to Kill Trump-Era Regs, Supervisory Construct

As presaged by Vice Chair Barr's testimony (see *Client Report* **REFORM217**), today's "unflinching" Fed report on SVB's failure pins a good deal of the blame on Trump-era tailoring rules and the Fed's accompanying light-touch supervisory construct. In the accompanying release, Fed Chairman Powell endorsed the report, reversing the votes he cast supporting the 2019 changes. We will shortly provide clients with an in-depth analysis of the report, which also assigns considerable blame to SVB management and supervisory reluctance to force remediation over the six years in which problems were spotted (years that began well before the supervisory rewrite on which the report in part focuses). Policy changes now planned by the Fed will address social-media related run risk, higher capital ratios, multi-scenario stress tests, more stringent resolution planning, and regional-bank TLAC. Other regulatory rewrites will be considered in future analyses, with the Fed now also focusing on redesigning its supervisory construct addressing banks with high growth

rates, concentrated business models, and novel activities regardless of size. In addition to our forthcoming initial analysis of the FDIC's imminent report, we are also monitoring Congressional response to these releases and will advise clients as these continue to emerge.

Bills Back GOP Anti-LLPA Push

Following demands earlier this week from top HFSC Republicans that FHFA reverse changes to the GSEs' loan level pricing adjustments (LLPAs), Reps. Lawler (R-NY) and Biggs (R-AZ) introduced separate pieces of legislation to prevent the agency's changes from taking effect. Rep. Biggs's bill has over thirty Republican cosponsors, although Rep. Lawler's has none. The Biggs text is thus the one from which HFSC action would proceed if, as seems likely, FHFA leaves LLPAs unchanged. As noted, LLPA legislation is unlikely to be enacted in this Congress even if measures advance in the House.

FDIC Bemoans NY Office Failings, Signature Bad Behavior

Following the FRB's SVB report and a critical one also on Signature's failure earlier today from the GAO, the FDIC released its own assessment of Signature's demise. The FDIC is still more emphatic that the bank it supervised failed due to poor management, saying it is now clear in retrospect that the FDIC should have escalated its concerns. Much of these internal problems are blamed on resource "challenges," a surprising finding given the FDIC's essentially unlimited resources from DIF premiums, with the agency reiterating its "forward-looking" supervisory philosophy without acknowledging significant structural flaws in the way it was administered. It will now study actions such as exam guidance for IDIs with significant uninsured-deposit reliance, revising liquidity risk-management standards, evaluating current supervisory protocols, and reviewing how examiners are allocated and how much work they are asked to undertake. We will review this report for any additional recommendations with policy impact, but the agency appears to be confining its comments on more sweeping FDIC-specific issues to the report expected Monday on deposit-insurance reform.

Basel Sticks With The Program

In remarks today, Basel Committee Chairman Pablo Hernández de Cos largely reiterated action items in the Committee's 2023/2024 work program, also emphasizing that monitoring of existing guidance in light of recent banking system turmoil does not amount to "reopening Basel III." He also urged against regulatory complacency, warned against regulatory rollbacks, and called for global cooperation to safeguard financial stability. Ongoing or upcoming Committee work outlined in de Cos's remarks includes publication within two years of a report on the digitalization of finance; analytical work addressing materiality gaps around climate-related financial risk; and a review of supervisory guidance and principles regarding banks' interconnections with NBFIs.

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Signature's NY Supervisors Blame Social Media

The New York Department of Financial Services (DFS) today blamed Signature's failure on a "confluence of events," most notably a social media generated deposit run that must be addressed via revisions to the liquidity coverage ratio. DFS also says its supervisory reports were accurate but not timely and its review process for supervisory reports is "cumbersome." It blames staff shortages, although it notes that hiring has recently picked up despite continuing pay disparities between examiner compensation and that in the private sector. It now also plans to consider whether banks need to conduct table-top exercises to demonstrate operational resilience and increase their own ability to clawback compensation and otherwise penalize management.

FDIC Puts Third-Party Banking in Freezer

Perhaps energized by its promises earlier today to improve supervisory responses, the FDIC today released a March 8 enforcement action against Cross River Bank, one of the most aggressive bank partners with fintech and other nonbanking institutions. The consent agreement mandates a significant improvement in board governance by immediately remedying problems spotted by the FDIC in 2021. Even more interesting, the bank is now ordered within fifteen days to identify all of its credit extensions, programs and arrangements as well as those with third parties. The bank is then to stop extending credit and working with any new third parties, moving forward its new third parties only if the FDIC does not object. In essence, the FDIC has put the business of third-party banking on hold at one of the most prominent institutions in this controversial arena, challenging the "rent-a-bank" model to which Chairman Gruenberg has long objected and putting other state-chartered non-member banks engaged in this arena under a very large gun.

Key Lawmakers Give Mixed Reactions To Bank-Failure Reports

Key Members of Congress were quick today to comment on the GAO, Fed, and FDIC reports analyzed earlier today for FedFin clients. Although Senate Banking Chairman Brown (D-OH) seconded the Fed's call for Trump-era regulatory repeal, his statement also made it clear that he wants substantive supervisory reform at the Federal Reserve with or without this action, planning to quiz Mr. Barr hard at future hearings. Ranking Member Scott (R-SC) took aim at what he described as a failure in Fed and FDIC supervisory culture and said the failures should not be used as "scapegoats" for a rollback of 2019 tailoring provisions or to justify stricter rules for well-run banks. Sen. Warren (D-MA) borrowed her assessment in part from Vice Chair Barr's, using the same term – "unflinching" – to describe the Fed's assessment of SVB's failure. She was also the only member to direct blame at Chairman Powell for what she called his supervisory failures. HFSC Chairman McHenry, who was the only member to acknowledge the GAO's report, praised it while calling those from the Fed and FDIC "self-serving" politicized

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attempts to validate additional regulation. He also noted that HFSC will hold hearings with banking regulators in May and Treasury Secretary Yellen in June.

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.

- **GSE-042723:** FSOC's newly-proposed analytical methodology for systemic risk identification is most immediately important for nonbank mortgage companies and the regulated institutions that love them.

- **SYSTEMIC95:** Rejecting the Trump Administration's hands-off approach to designating systemically-important nonbank financial institutions or activities and practices, the Biden Administration's FSOC has bifurcated this construct with one proposal on designating entities and another that lays out an analytical approach to identifying systemic risk that would then guide firm and activity designation as well as Council staff coordination with primary federal regulators leading to new rules, product or service prohibitions/restrictions, or firm-specific supervisory action.

- **GSE-042023:** FHFA yesterday proposed a sweeping rule that would codify Sandra Thompson's equitable- and fair-housing standards in a rule that any future FHFA director would have to work a lot harder to reverse.

- **CRYPTO42:** As we anticipated, the HFSC Digital Asset Subcommittee hearing today on federal stablecoin legislation did not entertain bipartisan expressions of support for the draft noticed with the hearing announcement.

- **CRYPTO41:** As anticipated, HFSC's hearing today with Chairman Gensler was a raucous affair which, while divided sharply on party lines when it comes to Mr. Gensler, also laid out general agreement on matters such as the need for stablecoin legislation (the topic of a high-profile hearing tomorrow).

- **GSE-041323:** As we noted earlier today, global regulators are rethinking their 2015 decision not to require an express capital charge for interest-rate risk, a shift with significant implications for the role of U.S. banks as mortgage lenders and investors.

- **IRR8:** As we noted yesterday, the head of the Basel Committee has targeted two capital and liquidity compromises included in the current Basel III construct not addressed in the end-game rules to which the U.S. plans shortly to turn.

- **COMPENSATION35:** Executive compensation incentives have proved among the most important reform priorities in the wake of recent bank failures.

- **REFORM220:** In this report, we drill down on prior forecasts (see *Client Report* **REFORM219**) of near-term regulatory action to identify the revisions sure to be prioritized as NEC Director Brainard and FDIC Chairman Gruenberg seek to reverse rules finalized over their objections when they were in the minority.

- **UDAP8:** Following its usual practice of setting standards by edict, the Bureau of Consumer Financial Protection has laid out an extensive framework that brings a wide range of consumer-finance actions and inactions within the scope of enforcement sanctions governing acts or practices that are not only unfair or deceptive, but also abusive.

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- **GSE-040623:** FHFA, Fannie, and Freddie yesterday updated the sometimes-controversial equitable-finance plans FHFA approved last year.

- **GSE-040323:** We have written from time to time about covered bonds.

- **REFORM219:** With Thursday's White House announcement, we know that the Administration will do its best to support Fed and FDIC efforts to color recent events as a failure of Republican-led rulemaking, not also one of agency supervisory acumen, speed, and even competence.

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