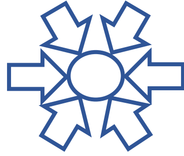

FedFin Client Report

Monday, April 3, 2023

FedFin Forecast: Probable Changes to Bank Supervision, Regulation, Law

Client Report: REFORM219

Executive Summary

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. So far, key Democrats are instead pursuing a two-track strategy: complaining mightily about Trump-era rules but also joining with Republicans to cite an array of supervisory lapses they want quickly remediated by new standards, new rules, and – if need be – also by new law. Indeed, on Friday, Democrats made it clear that they want considerably more from the Administration than the fixes on which the agencies prefer to focus. Given how much is in motion and how much could advance, this report details FedFin's forecast for near-term action in each of these arenas, focusing on matters with broad industry impact rather than specific SVB/Signature- enforcement issues. We thus provide forecast for immediate supervisory actions, those Congress will demand, new rules (tailoring and beyond), and the few legislative initiatives we believe have a reasonable chance of passage and Presidential approval.

Analysis

Supervisory Changes

It remains to be seen what the agencies will pledge after their reports are released and how transparent, measurable, and meaningful these will prove. At the least, we expect:

- the Federal Reserve Board to take a still larger role in supervision for all banking organizations with assets above $100 billion. It is likely that problems at the San Francisco Bank will also spur Congress to revisit the role of private-sector directors on Reserve Bank boards and legislation to make all Reserve Bank presidents subject to Presidential appointment and Senate confirmation. Indeed, this legislation has now been introduced;
- a review of banks without bank holding-company parents and the extent to which this obscures key financial and compensation information;
- more pressure for public CAMELS disclosures following Vice Chairman Barr's disclosures of aspects of SVB's rating and Congressional demands for greater transparency and accountability;
- new supervisory guidance detailing what will be done to ensure that fast-growing organizations are quickly recategorized for more stringent regulation and comprehensive supervision; and

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- FDIC efforts to reassert its role as back-up supervisor for IDIs it believes pose heightened resolution and/or failure risk.

Supervisory Changes

We expect that, in order to meet international commitments, the inter-agency "end-game" capital rules will advance on a separate track from post-SVB capital revisions to the tailoring rules. Despite strong GOP pressure to limit the cost of new capital standards, we think the end-game and tailoring rules will be tough on larger banks and expressly exempt all but specialized small institutions. The fate of Mr. Barr's "holistic" revisions is at best uncertain given everything else now before the Federal Reserve.

In addition, we affirm our forecast for:

- revisions to liquidity rules to reduce run risk (see *Client Report* **LIQUIDITY33**);
- a rewrite of capital standards to capture unrealized losses (and perhaps not also gains) for all banking organizations and/or revisions to the liquidity rules to allow only available-for-sale assets to qualify as HQLAs (see *Client Report* **REFORM216**);
- efforts to expand Category 2 standards to banks and BHCs with assets above $500 billion and/or other risk indicators;
- rapid action to finalize new large-bank resolution standards (see FSM Report **RESOLVE48**);
- rewrite of the extended schedule for living-will submissions adopted in 2021 to shorten the filing cycle for all banking organizations over $100 billion;
- broader overhaul of FDIC resolution options to increase the speed of source-of-support payments from parent holding companies as IDIs falter in order to reduce the likelihood of "shot-gun" acquisitions at considerable cost to the DIF or taxpayers;
- new FDIC standards for the special assessment putting the capitalization burden on larger banks;
- a rewrite of the FDIC's risk-based premium assessment schedule (see FSM Report **DEPOSITINSURANCE96**);
- revisions to brokered-deposit rules strongly opposed by FDIC Chairman Gruenberg (see FSM Report **DEPOSITINSURANCE111**);
- clarification of collateral rights between the Fed and FHLBs to prevent the kind of scramble that apparently impeded orderly resolution for Signature Bank;
- final action on long-delayed executive compensation rules (see FSM Report **COMPENSATION33**);
- revisions to the tailoring rules for foreign banking organizations (see FSM Report **SIFI34**) that reinstate proposed liquidity requirements for branches and agencies; and
- over time, structural changes to cross-border GSIB resolution standards, perhaps via a rewrite of the FDIC's 2011 OLA rules (see *Client Report* **RESOLVE6**) in concert with new ring-fencing standards for IHCs and expanded TLAC requirements (see FSM Report **TLAC6**).

If the agencies have any time to spare, they will also revisit rules strongly opposed by then-Governor Brainard and FDIC Director Gruenberg during the Quarles years, up to and including final

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Volcker rules (see *Client Report* **PROPTRADE26**) and margin-related capital requirements (see FSM Report **CAPITAL227**). However, we expect that the burden of all the rules and procedures deemed problematic post-SVB will almost surely preclude other regulatory rewrites. Even were this not the case, top banking-agency officials will also be closely engaged in FSOC review of issues such as the MMF and OEF rules highlighted on Thursday by Secretary Yellen and the broader review demanded Friday by Senate Banking Democrats.

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