FedFin Client Report

Thursday, May 17, 2023

HFSC Subcommittees Plow More Ground for Supervisory Accountability, Capital Reform, Clawbacks

Client Report: REFORM225

Executive Summary

A joint hearing today of HFSC's Financial Institutions and Oversight Subcommittees expanded on themes at yesterday's full Committee session with bank regulators (see *Client Report* **REFORM224**) and Senate Banking's session with SVB's and SBNY's CEOs, with First Republic's CEO now added to the Congressional firing line. Much in this session repeated prior themes, with Rep. Dave Scott (D-GA) going beyond prior, sharp criticism to accuse SVB's CEO of being the worst CEO in U.S. financial history. Democrats demanded that he give up the bonus he received the day SVB failed and he went to Hawaii, receiving little satisfaction on this score and continuing demands for clawback legislation. Rep. Bill Foster (D-IL) continued to argue that contingent-capital instruments would ensure smooth resolutions, a position he said is shared by Chairman McHenry (R-NC) even though it supports a controversial Fed/FDIC proposal for regional-bank TLAC (see FSM Report **RESOLVE48**). Republicans continued their assault on the Fed and, to a lesser degree, the FDIC, with Mr. McHenry again blaming monetary policy and lax supervision for recent failures and other Republicans demanding more Fed accountability for supervisory lapses. Echoing a theme Sen. Warren (D-MA) will raise at her hearing this afternoon, Subcommittee Chair Huizenga (R-MI) argued that the SVB's seat on the San Francisco Fed's board adversely affected supervisory judgment. This may be the last HFSC joint subcommittee hearing on regulatory policy if Ranking Member Waters (D-CA) presses the parliamentary objection she raised today to the absence of more full Committee deliberations.

Analysis

Opening Statements

Subcommittee Chairman Barr (R-KY) blasted the Fed and FDIC for what he called their lack of transparency and accused the agencies of narrative-setting rather than fact-finding; calling for action on this regulatory-reform legislation. Ranking Member Foster called for heightened attention to technological changes unaddressed in existing rules, noting that novel run risk will only increase. Oversight Subcommittee Chairman Huizenga called for an independent assessment of recent failures. Ranking Member Green (D-TX) echoed Senate Democrats yesterday on executive clawbacks and called for a return of bonuses.

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

© 2023. Federal Financial Analytics, Inc. All rights reserved.

Testimony

Messrs. Becker of SVB and Shay' testimony was the same as yesterday. Mr. Roffler, who did not appear yesterday, was emphatic that First Republic received no supervisory warnings from CFPB or the FDIC, noting that it has a history of taking these very seriously. However, his description of FRB's approach to rising interest rates emphasizes preparations to protect earnings, not ensure effective interest-rate and duration risk management. The bank's failure is blamed directly on contagion risk from SVB and SBNY, not any failings at First Republic.

Q&A

- **Run Risk:** Consumer Protection Subcommittee Chairman Luetkemeyer (R-MO) reiterated concerns about banking system susceptibility to social media-fueled run-risk via short-sellers and especially Chinese manipulation; Mr. Becker agreed that this should be addressed. Rep. Vargas (D-CA) later also raised concern over short-sellers and asked the CEOs for their input on potential solutions; Mr. Shay only advised that SBNY customers fled to megabanks due to their implicit guarantee.

- **FDIC Sale:** Subcommittee Chairman Barr focused on the FDIC's handling of FRC's receivership, asking Mr. Roffler if it began to distribute data about FRC prior to the week of its failure; Mr. Roffler said he did not think so. Mr. Barr also said that the FDIC was too slow in building a data room to facilitate SVB's acquisition. Rep. Huizenga asked Mr. Becker if the FDIC consulted him on potential SVB acquirers; Mr. Becker reiterated testimony from yesterday that they did not.

- **Regulatory Accountability:** Rep. Ogles (R-TN) asked the CEOs how forceful the FDIC was in its supervision of interest rate risk; Mr. Roffler said that the Committee might be interested in obtaining his bank's CAMELS ratings, which he said might shed more light on his claims that his bank fundamentally failed due to a contagion effect.

- **AOCI Capital Recognition:** Subcommittee Ranking Member Foster asked Mr. Becker if recognizing MTM losses on HTM securities would have altered the bank's behavior; Mr. Becker acknowledged that it would have forced the bank to raise more capital.

- **M&A Policy:** Rep. Fitzgerald (R-WI) asked the CEOs whether Biden Administration merger policy played a role in the banking crisis, arguing that the banking system requires strong regional banks able to acquire weaker banks.

- **Clawbacks:** Full Committee Ranking Member Waters called for executive accountability for bank mismanagement and said that Mr. Becker's securities sales prior to SVB's failure constitutes a golden parachute. Rep. Green asked if bonuses should be voluntarily returned; Mr. Becker replied that he would comply with regulators. Rep. Pressley (D-MA) asked if the CEOs believe they earned their bonuses, with Rep. Horsford (D-NV) asking if they believe bad behavior should be

© 2023. Federal Financial Analytics, Inc. All rights reserved.

rewarded. Reps. Posey (R-FL) and Norman (R-SC) also asked the CEOs about their stock sales and bonuses; Mr. Becker replied that the dates for payouts had been determined earlier in the year.

- **Incentive Compensation:** Rep. Sherman (D-CA) alleged that the banks failed due to greed enabled by a large risk, large bonus framework that encouraged reckless management.

- **Capital Requirements:** Rep. Timmons (R-SC) asked the CEOs whether increased capital requirements would have prevented failure; Mr. Shay said he wasn't sure, while Mr. Roffler said he did not believe so but that it is critical to retain tailoring in any new regulations.

- **Reserve Bank Composition and DEI:** Rep. Sherman took issue with the election processes determining regional bank board composition, calling these undemocratic. Reps. Timmons and Ogles (R-TN) reiterated longstanding Republican complaints around "woke" finance, claiming that a focus on DEI, "safe space catch-ups," and similar issues distracted the banks from focusing on more immediate challenges.

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

© 2023. Federal Financial Analytics, Inc. All rights reserved.