FedFin Weekly Alert

Monday, September 25, 2023

❑ SYSTEMIC STEPS

We held this weekly update on Friday because Washington was awash with rumors that FSOC would issue final versions of proposed systemic-evaluation standards (see FSM Report **SYSTEMIC95**) along with a new designation methodology (see FSM Report **SIFI35**). As it turned out, FSOC said so little in its closed-door meeting readout that it didn't suffice even for a client alert, let alone a weekly. Still, something is coming soon and, when it does, it will start yet another partisan and sometimes even emotional debate over financial regulation redefining the sector's strategic landscape.

As evident yet again last week at the HFSC Financial Institutions Subcommittee hearing on the need for holistic regulatory analytics, Republicans link much of their opposition to their Biden Administration abhorrence, leading Democrats to defend rules with which they are actually not all that enamored in order to defend Mr. Biden and his team. All this will play out all over again when FSOC opines. More substantively, FSOC's systemic standards are sure to draw reasoned concerns that they lack quantitative and qualitative impact analytics as well as a push from the other side that they are too little too late.

GAO recently issued a report saying FSOC should not just say what's systemic, but also regulate it whenever the Council sees it. This sentiment was not just endorsed, but expanded upon when FDIC Chairman Gruenberg last week addressed one of the most significant objections to the capital rules: that they will unduly empower nonbank financial intermediation. We said so in our capital-impact assessment (see *Client Report* **CAPITAL234**) and Karen Petrou said so in her testimony last week and will do so again later this week in public remarks. Many others will surely say the same. Still, unless the banking agencies make bigger changes than some of them will like, the structural implications of heightened regulatory arbitrage will grow only larger because FSOC can't go as far as GAO and Mr. Gruenberg would like to immunize the capital rules without new law.

This won't happen so rules must either significantly change or nonbanks will grow still more potent. That's not always bad when nonbanks don't take undue risks, but in systemic arenas such as the Treasury market and the rapid growth of private credit, it's super-scary.

Headlines From the Past Week's Daily Briefings

September 18

- **Dems Slam Fed Climate Scenarios -** Sens. Markey (D-MA), Warren (D-MA), Sanders (I-VT) and eight additional Democratic Senators and House Members sent a letter to Chair Powell

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demanding that the Fed ensures that the financial institutions it oversees properly address the threat of climate change.

- **Top Treasury Official Sounds Big-Tech Payments Alarm -** Treasury Assistant Secretary for Financial Institutions Graham Steele warned that Big-Tech firms' entry into financial services could result in increased market concentration and predatory pricing, highlighting their ability to leverage existing commercial relationships as well as network effects.

September 19

- **FSB Finally Takes Concrete CCP-Resolution Action -** Following longstanding announcements that it would advance CCP resolvability, the FSB released a consultative report recommending a toolbox approach to CCP resolution providing sufficient loss absorption and liquidity that is readily available and mitigates adverse effects on financial stability.

- **Treasury Advances Climate-Risk Principles, Not Mandates -** Cautiously advancing the President's climate-risk order (see FSM Report **GREEN8**), Treasury released nine nonbinding principles for net-zero financing and investment encouraging financial institutions to focus on limiting scope 3 emissions by implementing robust net-zero transition plans.

- **CFPB Expands AI Crackdown -** Expanding on last year's adverse action guidance (see FSM Report **FAIRLEND11**), the CFPB issued a circular stating that lenders – especially those using AI – cannot use CFPB sample adverse actions forms and checklists to deny consumers credit if the samples do not accurately portray the reasoning behind the denial.

- **HFSC Republicans Expand Attack From Capital to LTD Rules –** HFSC's Financial Institutions Subcommittee hearing on the economic consequences of the banking agencies' slate of recent proposals showcased strong Republican concerns.

September 20

- **Brown, Rounds Agree: AI Credit-Underwriting Warrants Regulatory Attention -** At the Senate Banking hearing on AI in financial services, Chairman Brown (D-OH) argued that AI should be governed by the same rules as the rest of the financial system, with new law necessary if existing rules prove inadequate.

- **HFSC FinCEN Bills Draw Bipartisan Support -** HFSC Chairman McHenry (R-NC) at the markup praised the scope of bipartisan support on today's FinCEN, sanctions, and other national security bills.

- **HFSC Delays Bipartisan Sanction Bill Vote -** HFSC's markup also considered two bills addressing sanctions policy: H.R. 5512 from Rep. Sherman (D-CA) to require bank subsidiaries to comply with sanctions on Russia and Belarus and H.R. 760 from Rep. Barr (R-KY) imposing blocking sanctions on Chinese defense or surveillance companies and the third-party companies that supply them.

- **HFSC Dems Continue Strongly Opposing GOP Anti-CBDC Measure -** The bipartisan spirit of the HFSC markup dissipated as Members fiercely debated H.R. 5403 from Majority Whip Emmer (R-MN), a bill that would bar the Fed from issuing a CBDC to individuals.

- **Gruenberg: New Shadow Bank Standards Would Cure a Capital Proposal Problem -** FDIC Chairman Gruenberg gave remarks arguing that FSOC along with OFR should establish a new

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reporting framework to assess the financial stability risks posed by nonbanks and ensure that public reporting is sufficient for market participants to understand nonbank counterparty risk.

- **HFSC Reports FinCEN, Sanctions, CBDC Bills -** HFSC unanimously reported H.R 760 sanctioning Chinese defense companies, H.R. 5512 requiring bank subsidiaries to comply with sanctions on Russia and Belarus, and H.R. 5472 and 5485 strengthening FinCEN oversight to the House floor.

September 21

- **Hill Stands by Opposition to Pending Rules, Presses for Holistic Liquidity Approach -** Reflecting his votes on all of the recent proposals, FDIC Vice Chairman Hill criticized recent rulemakings as an overreaction to March bank failures and urged regulators to carefully consider the proposals' aggregate effects amid uncertain economic conditions.

September 22

- **Bowman Stands Firm Opposing Pending Rules -** Making clear that her concerns with pending rules have in no way abated, FRB Governor Bowman stated that any proposal considered by the Board or jointly with the other banking agencies must be focused on remediating the identified concerns, informed by data and genuine discussion within each participating agency and with policymakers, and developed through a transparent process that is open to public comment.

This Week

Tuesday, September 26

Treasury's Federal Advisory Committee on Insurance Open Meeting. [1:30 pm, 1500 Pennsylvania Ave. NW.] Matters to be discussed: discuss topics related to climate-related financial risk and the insurance sector; discuss topics related to cyber insurance developments and international insurance issues; receive status updates from its subcommittees and from the FIO; and consider any new business.

Wednesday, September 27

HFSC Hearing entitled: "Oversight of the Securities and Exchange Commission." [10:00 am, 2128 RHOB]. **The Honorable Gary Gensler**, Chair, U.S. Securities and Exchange Commission.

Senate Banking Executive Session. [9:30 am: Dirksen Senate Office Building 538]. Matters to be discussed: the SAFER Banking Act of 2023.

Future Events of Note

No meetings of note.

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Recent Files Available for Downloading

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- **GSE-092023:** Or maybe it is, but not everyone has heard.
- **LIVINGWILL23:** Although a pending FDIC/FRB proposal imposes a raft of new requirements for resolution plans from IDIs with over $100 billion in assets, the FDIC has also issued a freestanding proposal doing the same, also setting information-filing standards for IDIs below $100 billion but above $50 billion.
- **CAPITAL235:** With HFSC Chairman McHenry (R-NC) leading the way, GOP Members of the panel's Financial Institutions Subcommittee today blasted the banking agencies' end-game proposal (see *Client Report* **CAPITAL234**).
- **LIVINGWILL22:** In conjunction with proposing a new long-term debt (LTD) requirement for categories II, III, and IV banks, the Fed and FDIC are pursuing other ways to enhance resolvability.
- **TLAC9:** Building on an advance notice of proposed rulemaking, the banking agencies have issued several proposals to enhance the resolvability of large banking organizations not covered by stringent GSIB standards.
- **GSE-083123:** As we noted yesterday, the global banking, securities, and insurance regulators who comprise the Financial Stability Board ((FSB) are heading back to look again at securitization to see if the post-08 framework it crafted still works.
- **GSIB22**: As anticipated in the wake of recent bank failures, the FRB has proposed a significant revision to the current rules calculating systemic-risk scores that lead to GSIB designation.
- **CAPITAL234:** With this report, we conclude our assessment of the regulatory-capital proposal with analysis of what the sum total of the credit (see FSM Report **CAPITAL231**), operational (see FSM Report **OPSRISK22**), and market (see FSM Report **CAPITAL233**) rules could do in the real world of banks, nonbanks, foreign banks, and complex market interconnections
- **CAPITAL233**: In this analysis, we turn to one of the costliest aspects of the proposed rewrite of U.S. regulatory-capital standards: the market-risk framework.

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