FedFin Daily Briefing

Tuesday, October 10, 2023

Barr Stands Firm on Capital Rewrite

In remarks yesterday, Vice Chair Barr made it clear that, no matter all the industry and Republican pressure, the Fed believes the pending capital rewrite has no material problematic consequences and is necessitated by recent events. Although it is possible that the capital rules could adversely affect macroeconomic growth, Mr. Barr counters by saying not only that prior warnings to this effect did not bear out, but also noting the critical public good of avoiding financial crises. Mr. Barr did, however, concede on one point: although the agencies' impact analysis refutes the potential for any portfolio reallocation due to changing RWAs (see *Client Report* **CAPITAL234**), Mr. Barr invites comment on any possible problems in this area. He also reiterated the request for views in the proposal (see FSM Report **CAPITAL231**) on the proposal's specific impact on LMI mortgage finance.

FSB Calls for Continued Improvements in Cross-Border Payments

Following its cross-border payments roadmap, the FSB today released two progress reports finding that further work is needed in ensuring payment system interoperability, establishing common data standards for payments messages, developing tools needed for APIs, and providing a vehicle for the investigation of legal, regulatory and supervisory frameworks. It also finds that lower income jurisdictions tend to be the farthest from cost and speed targets and that FX costs are the largest component of total costs. The FSB, along with CPMI and partnering organizations pledged to outline next steps on payments, focus on technical assistance, and consider addressing frictions from currency and capital controls.

FSB Presses for Better Smaller-Bank, GSIB Resolvability

Following Basel's review late last week on the 2023 crash (see *Client Report* **REFORM228**), the FSB today released its assessment of implications for GSIB resolution. Basel's report acknowledged challenges in this area, but largely focused on what we call Basel V. In sharp contrast, the FSB's analysis concludes that the SVB and SBNY failures show the need to consider even mid-sized banks systemic under stress and reassess the manner in which they are resolved. The FSB congratulates the U.S. on work already under way in this regard, but also plans to look at the need to expand global resolution and TLAC standards, ensure better preparation for high-speed bank runs, and address the role of uninsured deposits and how better to ensure continuity and depositor confidence. Looking at CS, the FSB concludes that a single-point-of-entry CS resolution would have been viable had Swiss regulators chosen to pursue it rather than the rescue/acquisition on which it decided. As a result, the FSB concludes that its GSIB-resolution attributes (see FSM Report **RESOLVE46**) remain viable. Even so, additional work will now commence on ensuring public-liquidity facilities and GSIB operational readiness to draw on them, legal challenges to use bail-in obligations such as AT1, and the financial-market reaction to TLAC triggers and other aspects of GSIB resolution.

Fed Finalizes DIHC Insurance-Capital Construct

As promised in the bank-capital proposals (see FSM Report **CAPITAL230**), the FRB Friday voted 6-0 to finalize long-pending standards for insurance-focused depository institution holding companies. The final standards largely track the proposed compromise between the FRB and state insurance regulators (see FSM Report **INSURANCE60**), mandating a new "building-block" approach which the Fed statement says is met by all covered firms. Dissenting from the final rule as she has recently begun to do in several cases, Gov. Bowman agreed with the capital construct but sharply rejected how much authority the rule delegates to Fed staff and, by inference the vice chair for supervision. Ms. Bowman views the authority-delegation as far too broad, pressing for express guidelines on its use and a requirement that staff refer all material issues back to the board.

GOP Hikes Pressure on Iran Payment, Sanctions

Presaging likely HFSC hearings and delays in regular committee action, Ranking Member Scott (R-SC) today called for Secretary Yellen to testify in front of Senate Banking to explain why $6 billion is being released to Iran and to identify any sanctions gaps. He states that the U.S. needs to signal to Iran that sanctions will not be eased while the regime funds terrorism, urging Congress to pass his bipartisan bill S. 1390 that would cement Iranian sanctions. He also presses for assessing the need for additional sanctions in response to the Hamas attacks.

Bowman Pursues Barr, Array of Recent Fed Actions

Continuing her opposition to much of what Vice Chair Barr is doing, remarks from FRB Governor Bowman today stressed that efficiency and minimizing cost and administrative burdens should be central to policymaking. For example, she states that the interagency third-party guidance (see FSM Report **VENDOR10**) acknowledged that community banks will need more resources to meet new expectations but failed to provide them. She also called for the Board to improve its approach to processing applications when the public objects so that concerns are appropriately considered without causing unnecessary delays. Doubtless referring to the USBC/First Union merger, Gov. Bowman also objects to imposing higher prudential standards as a condition of merger if these are not otherwise warranted in the tailoring standards. Ms. Bowman also again questioned the merit of singling out climate risks because its focus could adversely impact credit allocation decisions. She concluded by emphasizing the importance of feedback to the rulemaking process, highlighting the need to keep policymakers informed on the impact of proposed rules.

IMF Fears Bank Vulnerability, Presses Tougher Supervision/Standards

The IMF's new financial-stability report conclusions related to banking find that many banks – including some GSIBs – have significant exposure to capital losses due to HTM mark-to-market valuations and growing loan-loss reserves. Banks in Europe and the U.S. show the greatest vulnerability under the IMF's adverse severe-stagflation scenario. A substantial group of smaller banks in the U.S. are particularly vulnerable, although banks in China and Europe also face press due to flagging earnings. The Fund recommends enhanced analytics and tougher and more granular stress tests covering large banks and a greater number of smaller entities. The annual report also picks up on a prior set of supervisory recommendations, urging more "intrusive" bank supervision, operationalizing ready access to emergency liquidity support, and express capital standards for interest-rate risk (a tougher stand than the Basel Committee took last week, see *Client Report* **REFORM228**).

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- **REFORM228:** As we noted yesterday, the Basel Committee's October meeting concluded not only with plans for new disclosure consultations, but also a report on lessons learned from the 2023 crisis.
- **GSE-100223:** As we noted earlier today, the FRB has issued a seemingly technical FAQ liberalizing the treatment of certain credit-linked notes.
- **GSE-092523:** In her Congressional testimony last week, FedFin managing partner Karen Petrou focused on the unintended consequences wrought by new banking proposal based on their cumulative impact.
- **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.

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