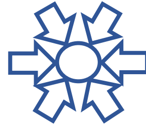
Beating Something with Something:
Reflections on Regulatory Advocacy in Challenging Times



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- Sound analytical and advocacy practices sharply increase the odds of substantive revisions.
- In the current context, this means a focus on perverse results counter to avowed agency objectives, critical concerns of undecided senior staff and officials likely to alter results.
- Objective analytics already show numerous areas of unintended, damaging consequences of several key proposals, especially when considered in toto and in the broader monetary, fiscal, and market context.
- Agency staff are strictly siloed and inter-agency cooperation is uncertain. Effective regulatory analytics, advocacy provide essential "cross-border" communication, proposed solutions.
- Political advocacy can reinforce key objectives and increase the odds of success, but are unlikely to throw entire rules off a moving train.

Ursula tells me that most of you are bent low under the weight of all the new rules the banking agencies have proposed. Trust me, we at FedFin know the feeling – the analytics behind our assessments of each of the new capital and resolution proposals of course required a great deal of work under tight deadlines. Importantly and as a framework for what I'd like to discuss today, I've concluded as many of you have that a good deal of what the banking agencies have proposed is warranted. What isn't warranted is their cavalier impact analyses falling woefully short for each of the rules and not even providing for the all-important cumulative-impact assessment essential to limiting unintended consequences. There thus is more than a fertile field for comments that, founded on objective analytics, will lead to substantive change and, should that not come, then a far stronger platform for litigation and political appeal.

Still, I don't want to spend our time together picking through the rules or even talking through impact analyses. My recent Congressional testimony[1] and other remarks[2] most recently do so, as does the FedFin work many of you receive.

Instead, I'd like to go beyond these assessments to suggest effective policy-advocacy tactics based on established practice to provide a record of what worked well in past cases when your predecessors faced like-kind franchise-value challenges. These practice guidelines are based on our work going back to the Basel I, II, and III rounds along with finalization of many of the rules mandated after the 2008 Great Financial Crisis. I'll bring this analysis forward to current, still more challenging circumstances, focusing in particular on issues facing regional banks without the established analytical teams housed at most GSIBs. Finally, based on my firm's recent analyses, I'll suggest a couple of starting points for the analytics underpinning advocacy that might well lead to regulatory change, obstinate though you may all think the agencies may be.

What Works?

Absent unquestioned supremacy, the key to success in regulatory advocacy as in much else is determining the objectives of key decision makers, identifying the terms on which each will concede to as much of one's own objectives as can be reasonably expected, and building the allies necessary to pressure otherwise-unwilling supporters. You all know this, but it's nonetheless helpful to break it down in the current regulatory decision-making process where the fortification lines are demarcated by regulatory-agency staff, agency voting decision-makers, Congress and divisions within likely allies are evident based on asset size and business model. Some of the regulatory advocacy I've seen is what I'd call brute force, threatening the proposals as a whole even though the odds of retraction or repeal are slim.

How much change can be achieved with sound analytics targeted to a proposal's weakest points with the most adverse strategic impact?

First, one needs to know what agency staff want. As in most organizations, it's mostly to make their bosses happy. This might imply that all final rules effectuate senior-management and official goals more or less stipulated at the start, but this is oversimplified.

Importantly, senior agency staff are often experienced agency staff who take pride in their own technical expertise and that of their staff. They too will do what they are told, but they often tell agency heads as much about what's going to be done as they are told. None but the most ideological or political agency voting officers will insist on regulatory provisions that staff believe are unworkable or counterproductive to agency mandates or financial stability.

Still, good staff intentions notwithstanding, silos at all of the agencies impede agency capabilities when it comes to cross-cutting effects such as those of the capital rules on resolvability and to broader cumulative implications, especially the monetary, fiscal, and global contexts that can frustrate even the most-reasoned regulations. Think for example of how the combined effect of capital and liquidity regulation in the last decade frustrated monetary-policy transmission as just one case in point.[3] Analytics telling one key set of agency staffers what another proposal does to their baby is a longstanding, effective advocacy technique, one likely to be particularly potent given the regulatory deluge.

And, most agency decision-makers generally won't see what staff doesn't show them unless the decision-maker has relevant expertise – often iffy – or someone forces them to look over the institutional parapet. Well-reasoned comment letters backed by effective presentations and a bit of not-too-partisan political clout can and often do this.

Congress is very, very good at forcing agency heads to look over the parapet, especially when an agency head wants another term or, as with the SEC and CFTC, the agency depends on appropriations. Still, as the SEC makes amply clear, Congress almost surely can't reverse any of the pending rules, but that doesn't mean it can't force change. When senior agency heads are of the party and share many of the same views as the Administration, the White House, FSOC, and other regulators are also key political, as well as substantive allies.

A Congressional caveat – and it's critical – is that change supported now only by Republicans won't change what Democrats will support or vice-versa if the pro/con rule debate is as partisan as it's recently become. In the past, Democrats and Republicans came together to press for changes to key rules – think of those to operational risk-based capital. When this occurred, the rules changed. Congress has of course become so, so much more partisan. Even so, bipartisan agreement can move seeming mountains.

How to Make That Happen?

Based on this taxonomy of regulatory decision-making, I'll now turn to how best to develop a triangulation strategy that mobilizes staff and Congressional influence on agency heads who may seem stubbornly set on the proposals more or less as is.

Importantly, given three banking agencies and varying opinions on the FRB and FDIC boards, you don't have to change everyone's minds. The key is getting those wavering in favor of change to join those already working to achieve it. I don't think there's consensus to be had to scrap the proposals as a whole or even in significant part. I do think substantive change is possible based on effective regulatory analytics backed by substantive advocacy.

As in many arguments, the best way to get allies and win as much as possible is to persuade potential supporters that what you want is in their own interest. Importantly, regulatory agencies do not care about bank profitability unless or until persuaded that profitability affects stability. Nor should they – profitability is your concern, not theirs unless you can show them a policy reason to align with your objectives. Here, the comparative advantage of banks versus nonbanks is a critical point of analysis and argumentation, but defining comparative advantage and persuasively attributing it to comparative advantage requires objective analytics linking key provisions to undeniable problems.

Two additional lines of argumentation are also extremely persuasive. The first is to map problematic provisions against each agency's own mandate and agency-head objectives and then demonstrate in key instances where getting what the agency proposes runs counter to what the agency actually wants. For example, the FDIC clings to the hope that uninsured deposits are in fact uninsured in an IDI resolution even though much in the long-term debt[4] and resolution-planning[5] proposals make them de facto insured.

Can you persuade the agencies to omit the operational risk proposal? I doubt it because the agencies' view that all banks have operational risk is right. What's not right is how the proposal would address it via regulatory capital. I'm told that Fed staff knows well that operational risk-based capital is best determined by models, not the Basel III lookbacks included in the interagency proposal.[6] It may well be hard to persuade the U.S. to back away from these standards in favor of the advanced measurement approach. And, even if this is possible, regional banks would need to reconcile themselves to more burden. Still, there's a better and considerably less costly operational-risk capital rule to be had. Hard data and what will go wrong with the ops-risk charge strengthens the hands of in-agency dissenters.

Is it possible to get regional banks wholly out of the market-risk requirement? GSIBs know they're stuck and are focusing very, very hard on market-risk fixes, but some regional banks are in hopes that nothing in this section of the capital rule will come to apply to them. I fear this is most unlikely because some regional banks do have significant market risk. But the agencies ask for comments on a materiality exemption and that's a request worth a whole lot of comment based on analytical assessment of what would happen if the market-risk rules apply to banks or exposures where additional risk is actually immaterial.

And, finally, analytical assessments with strong advocacy prospects can and should assess the extent to which a proposal is workable in practice no matter how dearly beloved its policy consequences may be to key agency staff and decision-makers. One obvious example is the FDIC's ability to do anything more than file all the complex resolution plans it demands in concert with the Fed and on its own. Chairman Gruenberg pointed out in 2019 that the FDIC was ill-equipped to handle a mid-size regional failure,[7] but nothing was done to enhance internal analytical, examination and enforcement capability. The FDIC's own assessment of Signature's failure makes no mention of its ability to intervene to ensure orderly resolution,[8] and its report on First Republic – where the emergency excuse is particularly implausible – is similarly silent on the vital resolution question.[9] So is the Fed's report on Silicon Valley bank,[10] where it could have noted far more directly the challenges handling the bank due to the FDIC's operational roadblocks and said at least something about why the Fed didn't make use of its source-of-strength authority to reduce FDIC resolution costs and limit the profiteering now evident at the still-operational parent company.[11]

And, just last week, the FDIC's Inspector-General made it all too clear that the FDIC has no capacity to deploy the power – OLA – congress gave it in 2010 as the ultimate prophylactic to any more "systemic" bail-outs. Under the new resolution rules, BHCs are to plan for resolutions that seem incongruous with bankruptcy as Congress intended for entities that aren't insured depositories and IDIs to plan for FDIC resolutions the FDIC cannot in fact execute. I think a good deal in the proposals makes sense, especially when it comes to operational resilience – but what would actually happen if banks fail, recovery plans falter, and the FDIC still can't shut them down? Sadly, that seems all too likely.

Will you get the Fed and FDIC to drop the whole thing by pointing all this out? Of course not, and indeed, nor should you. It's clear that more companies should file living wills coming under still more scrutiny. However, what can and should be done in part by regulatory analytics and in part by bipartisan political pressure aided by public commentary is alignment of the living-will goals demanded of banks with demonstrable Fed and FDIC ability to do anything but file them.

Will It Matter in the End?

There are so many areas in the body of the new proposals that cry out for substantive change based on what seem to be indisputable analytics. I've already mentioned several, but there are more we've spotted and still more you all have identified.

How can the banking agencies even posit conclusions of a "modest" impact in the LTD proposal when the proposal by the agencies' own admission is based on a "capital-refill" model meant to force banks to have capitalization equal to mandatory minimums far above those in the proposal if the parallel capital standards are implemented in anything close to current form? What if we undertook analytics to show that the amount of LTD debt needed to meet a capital-refill model under revised capital rules is anything but "modest" as it surely will be for many regional banks and then went on to assess the depth of a market and cost of issuance of eligible LTD in a higher-for-longer interest-rate regime? I suspect this analysis would show that the banking agencies are planning to mandate an unmarketable amount of high-cost debt with profound implications not just for regional-bank financial intermediation, but even franchise viability. I don't know this because we haven't done the analysis, but I know the agencies haven't done it either nor have they tackled many of the other hard questions glossed over by rule-by-rule assumptions that take little to no account not only of cumulative impact, but also of broader monetary-policy and financial-market conditions.

Perhaps at some point big banks will sue the agencies and perhaps even prevail. But any successful verdict will surely lead to appeal unless so much happens in 2024 that all of the banking agencies – confirmed heads with longer terms included – decide as a whole to back down on the validity of the rules as a whole. As I said at the start, there's no question in my mind that some of what's been proposed is warranted just as I know for sure that some isn't. Even the good parts might well backfire because no one has done the really hard work needed to know how the good parts work in concert and then cumulatively with all the other rules now on the books, those to come, and the external policy context and market environment which is decisive no matter how much the agencies try not to think about it.

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[4] Office of the Comptroller of the Currency (OCC), Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, (proposed August 29, 2023) (to be codified at 12 CFR Parts 216, 217, 238, and 252.) https://www.fdic.gov/news/board-matters/2023/2023-08-29-notice-dis-a-fr.pdf.

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[8] FDIC, "FDIC's Supervision of Signature Bank," (April 28, 2023), https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf.

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[11] Carmen Arroyo and Paula Sambo, "SVB Loan to Struggling Fintech Clearco Bought by Venture Backers," *Bloomberg*, (August 4, 2023) https://www.bloomberg.com/news/articles/2023-08-04/svb-loan-to-struggling-fintech-clearco-bought-byventure-backers?sref=BSO3yKhf and Todd Baker, "Unpicking the US deposit insurance debate," *Financial Times,* May 17, 2023. https://www.ft.com/content/e303e43e-272c-4138-9f6e-4e0981269c44.