FedFin Daily Briefing

Monday, November 13, 2023

Senate Banking GOP Demand End-Game Withdrawal, Holistic Review Release

Making still clearer their line of attack at tomorrow's hearing, all GOP Members of the Senate Banking Committee today sent Chairs Powell, Gruenberg and Acting Comptroller Hsu another letter demanding the withdrawal of the capital proposals. The letter largely reiterates concerns from the last time Vice Chair Barr appeared before the panel (see *Client Report* **REFORM226**), going on now to demand the release of his report on holistic regulation. We expect Democrats largely to defend pending rules, but will be monitoring closely for cracks on key considerations beyond the mortgage and green-bond issues raised at prior sessions.

FRB-PHL: Fintech Spots Credit Risk Better than Banks

A new study from the Federal Reserve Bank of Philadelphia finds not only that fintech loan-risk scoring performed well during the pandemic, but also that the proprietary loan rating systems of large fintech companies better predict default likelihood in the personal loan market compared to traditional measures of credit risk. Although the study relies solely on one firm's data, the authors also find that default rates for nonprime consumers are much lower for large fintech loans than traditional personal loans, arguing that this finding buttresses the role of alternative data in identifying so-called "Invisible Prime" consumers from the nonprime pool. Using loan-level data from LendingClub's consumer platform for loans originated between 2014 and 2019 in conjunction with economic factors from the Census Bureau and credit card-level data from FRB-NY, the authors also find no evidence that fintechs "cream skim" (that is, underprice the cost of credit to top-tier customers). Here, they argue that analyzing borrowers' true default risk rather than FICO score alone is necessary to determine whether fintechs are cream-skimming, pointing to loan-level data indicating that LendingClub does the opposite. The paper does not offer direct policy conclusions, only emphasizing that regulators should continue to consider the consumer benefits of alternative data. However, it is unclear to us if like-kind findings are likely if the study were extended to a broader fintech sample.

Barr Stands By His Proposals

Vice chairman Barr's testimony for forthcoming hearings emphasizes that the banking system is resilient and sound, eschewing the caveats included in Friday's supervisory report about pockets of weakness. However, Mr. Barr does note risks due to factors such as growing reliance on high-cost funding, unrealized losses, uninsured-deposit concentrations, and growing loan losses. After describing supervisory improvements underway in the wake of recent failures, Mr. Barr strongly defends pending proposals on grounds that neither banks nor supervisors can anticipate all risks, noting also key provisions in the recent CRA standard. Mr. Barr does not address potential cumulative implications nor the need for a "holistic" approach. As noted earlier today, we expect Republicans to take Mr. Barr to task principally over the capital rule while Democrats defend it at least in broad terms. We will note any key points in Messrs. Gruenberg and Hsu's statements when these are released and provide clients with an in-depth analysis of these hearings upon their conclusion.

Gruenberg Defends DIF Rewrites

While echoing comments from Messrs. Barr and Hsu about the sound banking system, FDIC Chair Gruenberg's testimony pointed to what he called significant downside risk from higher rates, geopolitical tension, unrealized losses, and other factors. He also addressed changing deposit flows, noting that sharp growth in large-bank deposits during the first quarter have not been sustained as deposits moved to higher-yielding instruments outside the banking system. However, insured-deposit totals have risen to an annual rate Mr. Gruenberg believes validates the agency's controversial decision to hike DIF premiums (see FSM Report **DEPOSITINSURANCE116**). The testimony also describes the special-assessment proposal (see FSM Report **DEPOSITINSURANCE120**) now set for finalization on Thursday and defends recent prudential proposals and describes its actions following recent failures.

Hsu Differentiates OCC Supervision, Defends Regs

Acting Comptroller Hsu's testimony reiterates Mr. Barr's comment about a sound banking system, pointedly noting that all of the recent failures were state-chartered. His statement runs through a more complete list of pending rules and recent actions, adding to Mr. Barr's list the new climate-risk principles (see FSM Report **CLIMATE17**) defending them against certain GOP criticism on grounds that climate risk poses unique financial risks. Mr. Hsu also emphasizes proportionality in OCC rulemaking and supervision.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **SIFI37:** In concert with finalizing a new systemic-risk methodology, the Financial Stability Oversight Council issued guidance that significantly rewrites the manner in which nonbanks are designated as systemically important financial institutions (SIFIs), largely retaining its initial proposal.

- **SYSTEMIC98:** Rejecting the Trump Administration's hands-off approach to designating systemically-important nonbank financial institutions or activities and practices, the Biden Administration's FSOC has finalized its bifurcated proposals to designate systemic entities and another laying out an analytical approach to identifying systemic risk that would then guide firm and activity designation as well as Council staff coordination with primary federal regulators.

- **GSE-110823:** Although FHFA calls its FHLB report a centenary event ahead of the System's 2032 birthday, the agency clearly plans structural substantive reform well before that milestone.

- **CLIMATE17:** The banking agencies have joined together to issue inter-agency climate-risk guidance based on proposed standards from the FDIC, OCC and FRB.

- **INTERCHANGE12:** As suggested when the Fed last year finalized controversial new debit-card routing requirements, the central bank is now proposing a sharp reduction in the cap mandated on debit-card interchange fees under the Dodd-Frank Act's Durbin Amendment for debit-card issuers with over $10 billion in assets.

- **AI3:** In this report, we assess the detailed executive order (EO) issued late Monday afternoon after days of private showings of selected versions.

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- **DATA4:** Following a request for information that was a de facto advance notice of proposed rulemaking, the CFPB has now proposed a preliminary, but binding framework for consumer data rights covering consumer "transaction" accounts offered by banks, credit unions, and – a departure from the initial outline – nonbanks/fintechs.
- **GSE-102323:** As noted in our report earlier today, the Federal Reserve's latest financial-stability report expresses deep misgivings about complex securitizations.
- **SYSTEMIC97:** As promised, this in-depth report assesses Friday's semiannual financial-stability report from the Federal Reserve.
- **DEPOSITINSURANCE122:** Bipartisan senators have introduced legislation to provide FDIC coverage for certain noninterest-bearing transaction accounts, a move designed to prevent the stress and potential systemic risk evident when Silicon Valley and Signature Banks failed in March.
- **GSE-101723:** As we noted earlier this month, the Federal Reserve inserted a significant capital provision for credit-linked notes in an otherwise-obscure FAQ.
- **GSE-101623:** The White House today rolled out a new housing plan that smacks mightily of many old housing plans.

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