FedFin Daily Briefing

Wednesday, November 29, 2023

FDIC's OIG Presses for Non-Capital PCA Triggers, Additional Supervisory Reform

The FDIC's OIG report on First Republic's failure is at least as scathing as its SBNY post-mortem. As in the past, the OIG recommends establishing non-capital PCA triggers, a point Karen Petrou emphasized following GAO's renewed recommendation to this effect after the mid-March failures. The ten additional recommendations generally focus on improved FDIC procedures that would more quickly catch safety-and-soundness problems and either force remediation or impose sanctions. As before, the FDIC also wants improved liquidity-stress testing and better understanding of deposit volatility. The OIG again also suggests "real-time" monitoring of reputational risks such as market capitalization, short-selling, and social media. As a reminder, First Republic's losses – now estimated at $15.6 billion – are not reflected in the final special assessment (see FSM Report **DEPOSITINSURANCE122**). The FDIC agreed with all of the OIG's recommendations and plans to implement them by July of 2024.

Treasury Launches Anti-Crypto Enforcement Campaign

In remarks today from Deputy Secretary Wally Adeyemo, Treasury officially launched its anti-crypto sanctions and AML campaign. Treasury is convinced that crypto has played a major role in Hamas financing and other recent problems, calling on Congress to change the BSA and CFT laws to expand their express reach to a raft of digital-asset products, including those handled via DeFi. Treasury also wants Congress to expand secondary sanctions so that crypto activities can be sanctioned by correspondent banks or other entities. Mr. Adeyemo also calls on digital-asset entities to create voluntary fraud-reporting exchanges akin to the one announced yesterday by the ABA, also noting stepped up U.S. work to prevent jurisdiction evasion and otherwise increase international enforcement in this arena. Cryptoasset legislation is currently a subject of considerable dispute, with HFSC Chair McHenry (R-NC) trying to add his bill to realign domestic enforcement between the SEC and CFTC to the National Defense Authorization bill and Democrats in both the House and Senate staunchly opposing doing so. If Senate Banking advances Treasury's wish-list via the NDAA (unlikely) or in freestanding legislation next year, then the McHenry approach could stand a better chance of enactment, perhaps along with long-pending stablecoin legislation.

Basel Proposes Sweeping Climate-Risk Disclosure Standards

Following the FSB's finding that most banks were failing to provide meaningful climate disclosures, the Basel Committee today issued proposed climate-risk disclosure standards. These follow Basel's usual model of mandating both qualitative and quantitative disclosures. While there is no stand-alone section focused on scenario analysis, resilience-related disclosures rely on extensive scenario-analysis results and procedures. The quantitative disclosures are also extensive and include controversial Scope 3 standards, also requiring calculation and disclosure of metrics related to factors such as geographic exposures and credit risk in order to enhance comparability across the worldwide banking sector. Comment, due February 29, is sought on many of the proposed metrics as well as on proxies that could be used while data systems are developed.

3Q Report Highlights AOCI Risk

The FDIC's 3Q banking-condition report includes a stunning 22.5 percent rise in the total of HTM and AFS unrealized losses, which now stand at $683.9 billion. The change of course results from higher rates but will doubtless heighten concerns at any bank subject to liquidity stress and strengthen agency resolve to address AOCI in pending capital changes (see FSM Report **CAPITAL230**). Total problem banks now stand at 44, up by one and a total of $7.5 billion suggesting a new small-bank problem. Deposits were down, permitting the DIF to rise to 1.13 percent and reducing the cost of any DIF hikes due to the First Republic losses noted earlier today.

Senate Banking Opens Private-Credit Inquiry

Senate Banking Chair Brown (D-OH) and Sen. Reed (D-RI) today asked FRB Vice Chair Barr, Acting Comptroller Hsu, and FDIC Chair Gruenberg to look into the risks private credit poses to the banking system. Although private credit went largely unmentioned in the Fed's most recent financial-stability report (see *Client Report* **SYSTEMIC97**), other agencies have increasingly raised concerns about the health of private-equity firms and potential asset-price risk if fire sales are forced by sudden credit loss. The senators are most concerned with inter-connections into the banking system, pointing to bank loans to private-credit funds, deal partnerships, and "exotic" risk transfers to these funds. Regulators are asked if they share these concerns, if they need more resources to address those arising outside the banking system, and the status of ongoing monitoring. No deadline is set for a reply, with the letter clearly intended as a shot across the bow to get the regulators to erect new firewalls in this sector.

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.

- **CONSUMER53:** In sharp contrast to most recent HFSC hearings with CFPB Director Chopra, today's session was relatively calm.
- **GSE-112723:** The most significant thing in FHFA's final capital rule is not what is to be done, but what FHFA left out: ending the GSEs' advanced-approach requirement.
- **DEPOSITINSURANCE122:** As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic, the FDIC has finalized its proposed approach to imposing a systemic assessment to reimburse the Deposit Insurance Fund (DIF) for the resolution costs related to uninsured deposits following a systemic designation.
- **GSE-111623:** As our reports on the Senate and House hearings with bank regulators made clear, our prediction that the agencies would compromise on mortgage risk-based capital requirements will prove itself in the final standards.
- **REFORM230:** Following yesterday's Senate Banking hearing (see *Client Report* **REFORM229**), today's HFSC session with top bank regulators again highlighted growing bipartisan consternation over the unintended consequences of the agencies' capital proposal (see FSM Report **CAPITAL230**).

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- **PAYMENT27:** Building on its director's longstanding focus on fintech and tech-platform companies, the CFPB has proposed to extend its supervisory reach to nonbank providers of general-use digital payments services.

- **REFORM229:** Today's Senate Banking hearing with top bank regulators showcased broad bipartisan concern over the interagency capital proposal (see FSM Report **CAPITAL230**).

- **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.

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