



FedFin Client Report

Wednesday, November 15, 2023

Bipartisan Capital Bashing Continues in the House

Client Report: REFORM230

Executive Summary

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](#)). Although Ranking Member Waters (D-CA) echoed Chairman Brown's defense, Democratic criticism today went beyond concerns about mortgages and green bonds also to address credit availability, new trading and derivatives standards, capital recognition of securities losses, and insufficient review of the proposal's quantitative impacts. Republicans continued to bash the proposal for what they said is insufficient economic analysis. Unlike yesterday, attention to the FDIC's harassment scandal most notably came from Democrats' side of the aisle, with Ranking Member Waters using all of her questioning time to criticize the FDIC and request a report from each agency describing how they will review sexual-harassment. Reiterating concerns he and Subcommittee on Financial Institutions Chairman Barr (R-KY) recently raised regarding regulators' interactions with international standard-setters, Chairman McHenry grilled Vice Chair Barr and Acting Comptroller Hsu about staff compensation and agency documentation practices at international events. Mr. Barr emphasized that all Board and staff member compensation comes from the Fed, while Mr. Hsu only said that his agency tracks participation in these bodies to ensure mission alignment. We continue to expect GOP pressure on the international-agency front but no action until GAO completes its [report](#). Chair Gruenberg noted broad alignment with a new incentive-compensation proposal, but revised the initial timeline for an NPR from year-end to early next year.

Analysis

Opening Statements

Chairman McHenry excoriated the capital proposal for what he called its "shocking" lack of quantitative analysis and its effects on credit availability, arguing that it does not address the root causes of March's bank failures and accusing the regulators of acting politically. Stating that new, final climate risk principles ([see FSM Report CLIMATE17](#)) run afoul of the APA, he will request a GAO exam to determine whether the principles constitute a rule subject to the

Federal Financial Analytics, Inc.
2101 L Street, NW – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com

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Congressional Review Act. Ranking Member Waters praised both the capital proposal and CRA [finalization](#). She also urged House Republicans to advance executive compensation measures and consider legislation to strengthen deposit insurance. Rep. Foster (D-IL) urged the regulators to focus on emerging risks such as AI, cyber risk, and climate change.

Testimony

The regulators' testimony was the same as that delivered to Senate Banking yesterday.

Q&A

- **Capital Proposal:** Democrats including Reps. Velasquez (D-NY) Scott (D-GA), Himes (D-CT), Foster (D-IL), Cleaver (D-MO), and Meeks (D-NY) focused on the Fed's economic analysis, capital recognition of unrealized losses, new derivatives and trading standards, the current state of bank capitalization as well as the proposal's impacts on small-business and farm-lending and mortgage option access for LMI borrowers. Responding to Reps. Velasquez's and Scott's credit availability concerns, Mr. Barr noted that the proposal has unchanged or lower risk weights for small business lending and repeatedly argued that the rule would not significantly change credit availability. He also argued that the proposal will improve bank resilience and ultimately serve consumers. He also reiterated that the banking system is sound and defended the capital proposal on grounds that it identifies areas where risks are not appropriately calibrated. Rep. Sherman (D-CA) asked if the regulators are considering requiring recognition of unrealized losses on all securities; Mr. Barr noted the proposal's focus on AFS securities, something Rep. Sherman called a "tiny step forward" that effectively discriminates against small businesses. Rep. Sherman also asked the regulators to defend what he said was a decision to create zero value for mortgage insurance; Vice Chair Barr said that the proposal's treatment of private MI is the same as now (which we would note is not true with regard to standardized approach banks ([see FSM Report CAPITAL231](#))). Republicans including Reps. Huizenga (R-MI), Wagner (R-MO), and Williams (R-TX) also took issue with what they said was the proposal's insufficient economic analysis, asking Vice Chair Barr about the cumulative effect of recent rulemakings on consumer credit access and securities underwriting. Mr. Barr assured them that the Fed looks at the overall effect of its rules and does not anticipate that the capital proposal will negatively impact lending. Notably, Chairman Gruenberg expects that the final rule will address concerns about credit availability as well as mortgage risk-weights.
- **Custody Rule:** Flagging the SEC's custody rule ([see FSM Report CUSTODY5](#)), Rep. Hill (R-AR) asked Mr. Hsu if holding client cash off balance sheet represents a fundamental shift in bank practices; Mr. Hsu said it does, noting that the OCC has looked at mandatory cash segregation and acknowledging that he has concerns about the SEC's approach, a sentiment Vice Chair Barr echoed. Mr. Hill also urged Vice Chair Barr to respond to his

and Mr. McHenry's [letter](#) regarding the novel activities rule, emphasizing the need to justify safety and soundness arguments. Rep. Davidson (R-OH) later asked Acting Comptroller Hsu to comment on the impact of expiring digital asset custody services guidance; Mr. Hsu only emphasized the OCC's safety and soundness mission, noting crypto's risks.

- **M&A:** Rep. Hill asked Chairman Gruenberg to provide a list of pending bank M&A applications and note the length of time since each was accepted; Chairman Gruenberg said he would. Rep. Hill also asked NCUA Chairman Harper to provide a memo detailing credit union acquisitions of banks over the last year; Mr. Harper said he would.
- **Stablecoins:** Rep. Hill asked Acting Comptroller Hsu if the OCC has the authority to charter non-depository trust banks capable of issuing stablecoins; Mr. Hsu said it does, noting that it must be done in a safe and sound manner. Rep. Hill also asked if the OCC is capable of supervising these institutions should they issue stablecoins; Mr. Hsu said he believed it could.
- **LTD Proposal:** Taking serious issue with the LTD proposal, Rep. Sessions (R-TX) asked if the March bank failures served as the catalyst for the rulemaking; Mr. Gruenberg denied this, stating that it is a long-standing priority.
- **Sanctions:** Sounding the alarm over Chinese geopolitical threats to financial stability, Rep. Luetkemeyer (R-MO) asked Mr. Hsu about the regularity of Treasury meetings to assess this risk and develop a sanctions blueprint for China; Mr. Hsu said meetings are held often, noting that banks should be prepared for a range of sanctions scenarios.
- **Interchange Rule:** Sharply criticizing the pending proposal ([see FSM Report INTERCHANGE12](#)), Rep. Luetkemeyer asked Vice Chair Barr if he is concerned that consumers will pay more; Vice Chair Barr only said the rule is a Congressional mandate.