FedFin Client Report

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Moderate Democrats Continue to Voice End-Game Doubts

Client Report: GSIB23

Executive Summary

The agencies' capital proposal (see FSM Report **CAPITAL230**) unsurprisingly dominated discussion at today's Senate Banking hearing with big bank CEOs. Also unsurprisingly, Republicans and the CEOs sharply criticized what they called insufficient economic analysis and downstream lending impact. Despite positioning themselves for a defense of the Fed's GSIB surcharge proposal (see FSM Report **GSIB22**), the proposal received little attention from Committee Democrats or, for that matter, Republicans or the CEOs. Sen. Warner (D-VA) echoed FRB Vice Chair Barr's remarks by calling on banks to be much better prepared to use the discount window, announcing legislation that would require mandatory window usage on an episodic basis to ensure readiness under stress. On the receiving end of much of the questioning was JPM CEO Jamie Dimon, who consistently battered the capital proposal on grounds that it fails to address the underlying causes of this year's bank failures. Noting that "banks pay for the FDIC," he at one point also noted that his bank would "love" to take over the agency. Chairman Brown (D-OH) laughingly said he would have to consider the option.

Analysis

Opening Statements

Chairman Brown defended the need for stronger capital requirements, which he called "common sense," arguing that Wall Street cannot be trusted to self-regulate and excoriating lobbyists for advancing claims that stronger rules will hurt working families. He also pressed for passage of his bipartisan clawback bill (see FSM Report **COMPENSATION37**). Ranking Member Scott (R-SC) countered Chairman Brown, emphasizing that the capital proposals will indeed reduce and have a "devastating" impact on small businesses. He reiterated that regulators should withdraw the proposal, also calling for much more sophisticated regulatory understanding of how recent rulemakings interact with each other.

Testimony

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Criticizing what he called a "propose now, study later" strategy, JPM CEO Jamie Dimon said there was "zero evidence" that U.S. banks are undercapitalized, argued that none of the proposed changes would have prevented SVB's collapse and emphasized that they would result in increased financial system risk to product migration to nonbanks. Wells Fargo CEO Charles Scharf emphasized his bank's domestic presence as well as efforts to reduce and simplify consumer fees. Although he noted that his bank already has the capital to meet proposed new capital standards, BOA CEO Brian Moynihan defended industry pushback against the capital proposal and argued that capital should not be subject to "regulatory capture." Citibank CEO Jane Fraser highlighted macroeconomic risks, noting "concerning" signs in the lower end of FICO-score segment of her bank's customers and calling higher capital requirements a "bad idea." State Street CEO Ronald O'Hanley focused on the importance of custody banks, also calling for an effective digital asset regulatory framework. BNY Mellon CEO Robin Vince stressed the need for forward-looking public and private sector action on emerging technologies including AI and DLT. Goldman Sachs CEO David Solomon and Morgan Stanley CEO James Gorman emphasized that their banks are much less risky than they were before the GFC and stressed that increased capital requirements would be both harmful and unnecessary.

Q&A

- **Capital Proposal:** Chairman Brown asked each of the CEOs if they believed their firms would be unable to achieve proposed increased capital requirements; none said they would be unable to do so. Ranking Member Scott revised the question, asking the CEOs if they can meet the requirements without incurring economic and consumer lending harms; Messrs. Scharf, Moynihan, and Dimon emphasized the capital proposal's lending pitfalls. Sen. Rounds (R-SD) asked the CEOs if proposed regulations could negatively impact first time homebuyers, retirement saving, farmers and ranchers, and small business owners; each CEO agreed that they could. Sen. Tillis (R-NC) called the capital proposal "bad" and asked Mr. Gorman for his views on operational risk requirements; Mr. Gorman said it makes no sense to punish institutions for fee-based business. Sen. Tillis also asked Mr. Solomon to explain how the proposal's effect on securities financing transactions would affect pension funds; Mr. Solomon said it would make them uneconomical, causing banks to exit the business and thereby limiting pension fund cash access. Sen. Lummis (R-WY) sharply criticized the proposal's credit risk provisions, raising concerns that it could negatively impact mutual fund investment; Mr. O'Hanley called the proposal's counterparty risk standards a crude measure of risk. Sen. Hagerty (R-TN) sharply criticized the banking agencies for what he called a failure to consider the capital proposal's knock-on effects, asking Mr. Dimon for his views on its economic impacts; Mr. Dimon emphasized its "extreme" effect on market-making and highlighted that it would diminish mortgage access for LMI borrowers. Sens. Hagerty, Lummis, and Britt (R-AL) also asked Ms. Fraser and Mr. Solomon how the proposal would impact U.S. banks on an international basis; both agreed it could put U.S. banks at a competitive disadvantage. Sen. Britt sharply criticized the proposal on grounds that banks with under $100 billion in assets would be negatively impacted; all of the CEOs agreed. Sen. Daines asked Mr. Dimon to explain the rule's trickle-down effects; Mr. Dimon said there are many unintended consequences, emphasizing cumulative effects that would raise prices.

- **Banking Sector Strength:** Sen. Scott emphasized that banks are well-prepared to weather an economic crisis; agreeing, Mr. Solomon argued that stress tests results prove that the system is secure. Sen. Fetterman (D-PA) asked if legislators should be skeptical of banks' assurances of having sufficient capital; Mr. Moynihan emphasized what he called significant regime change and higher capital standards since the GFC. Sen. Fetterman also argued that SVB's collapse demonstrated that rule changes are necessary; Mr. Dimon said that, while regulators should target excessive IRR, this has nothing to do with Basel III.

- **Discount Window:** Sen. Warner as noted argued that banks should be much better prepared to use the discount window and asked the CEOs if they believed occasional mandatory usage would be beneficial; Mr. Moynihan said most of the institutions represented at the hearing were prepared to use the window and agreed that industry stigma should change. Sen. Warner promised to introduce legislation that would require some mandatory use on an episodic basis.

- **Crypto:** Pressing her bipartisan bill, Sen. Warren (D-MA) asked Mr. Dimon to explain why crypto is an attractive tool for illicit financial activity; Mr. Dimon emphasized crypto's true use case is criminal and encouraged the government to "close it down." Sen. Warren also asked if crypto companies should follow like-kind AML rules; all of the CEOs said they should.

- **Nonbank Migration:** Sen. Tester (D-MT) asked Ms. Fraser for her views on how the capital proposal would impact migration of financial activity to nonbanks; Ms. Fraser said this is a worry, noting it could undermine financial system stability.

- **Illicit Finance:** Sen. Tester asked the CEOs to explain how their institutions avoid financing illicit activity; Mr. Gorman called this an extraordinary effort and said AI will be a helpful compliance tool going forward.

- **Financial Inclusion:** Raising concerns about banking deserts, Sen. Menendez (D-NJ) asked how the CEOs believed they could maintain access to community banking services; Mr. Moynihan noted that 97 percent of his bank's LMI customers use digital banking and defended large banks.

- **Stress Testing:** Sen. Tillis called the notion that banks are able to "game" CCAR absurd, asking if banks are devoting too much time to satisfy stress testing requirements rather than focusing on "real" risks; Mr. Dimon called stress testing "out of control."

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- **AI:** Sen. Warner argued that FSOC should take on AI; Ms. Fraser said the topic is a huge concern, noting considerable threats but also highlighting that current regulation effectively safeguards the financial system. Sen. Smith asked Mr. Solomon how GS is deploying AI internally and for his views on AI guardrails; Mr. Solomon said his firm has been using AI for quite some time and said his firm is particularly focused on AI cybersecurity threats, also calling for regulations as the technology advances.

- **Interest Rate Cap:** Sen. Reed (D-RI) asked the CEOs if they would support a national 36 percent interest cap; Mr. Scharf said he would have concerns about a flat number, while Ms. Fraser emphasized that other approaches should be considered. Several other CEOs supported the notion, with Mr. Gorman calling lending at 36 percent "unforgivable."

- **CRA:** Sen. Smith (D-MN) praised the CRA rulemaking and asked Mr. Scharf if the rule would better enable banks to meet their lending obligations; Mr. Scharf said rethinking CRA has been helpful.

- **Overdrafts:** Broadly defending the CFPB, Sen. Menendez argued that banks should eliminate overdraft and NSF fees and would remain profitable if they did so.

- **FedNow:** Boosting FedNow, Sen. Van Hollen (D-MD) asked for updates about the banks' participation in the service; Messrs. Scharf and Dimon confirmed that WF and JPM have joined the system, while Ms. Fraser and Mr. Moynihan said their banks are working through technical issues.