Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: January 22, 2024

We said from the start that finalizing the capital rules as proposed would be difficult because I have truly never seen a sweeping rule buttressed by such shoddy analytics. It's of course true that lots of rules make little sense, but rules that cost companies as much as the capital rules are uniquely vulnerable to substantive and legal challenges. This is even more likely when, as now, the proposal's victims know how to temper political claims with well-founded assertions of analytical flaws and unintended consequences. When regulatory credibility is effectively undermined, even those who might otherwise side with the regulators become cautious, if not actually averse to doing so. And thus, it has come to pass for the end-game rules.

As our analyses of all of the comment letters filed last week by dozens of Democrats make clear, only a few super-progressive Democrats now stand firmly with the regulators and even they have a few qualms. Maybe the agencies will try to bull it out – we thought so as recently as early this month in our outlook. We were clear there that major changes would need to be made to finalize the end-game rules; now, we're not sure even these will do. The odds now are considerably higher for the re-proposal pressed last week by FRB Govs. Waller and Bowman.

The agencies are of course not naïve. They knew that the final rule would have to show a few concessions to its critics. As a result, the proposal included a transparent maneuver in which the agencies offered to give the banks a bit when it comes to mortgage loans for low-and-moderate income households. This tiny olive branch was supposed to show that the agencies cared about vulnerable communities and weren't unwilling to change, but how they thought that this and a few technical corrections would do the trick is a mystery. But thus they thought.

It soon became clear that more than technical corrections were needed if the agencies were to keep Democrats on their side. This pertains to one hallmark Biden Administration achievement: tax-equity bonds for clean energy. Democrats quickly spotted problems here and the agencies just as quickly promised to fix this too. They hoped as recently as the New Year that substantive changes would end with mortgages and these bonds, but the withering fusillade of detailed industry comments backed in many cases even by very liberal Democrats now makes it clear that the end-game rule is anything but almost finished.

There has been considerably less attention to the capital rule's fellow traveler, proposed long-term debt (LTD) requirements for bank holding companies and insured depositories with as little as $100 billion in assets. We have discerned not a single comment letter on the LTD proposal from the Hill, but it drew a stunning rebuke from one key interest group whose comments almost always tell Biden regulators how much it likes what they do if only they did still more of it. This letter comes from Better Markets, siding firmly with those – ourselves very much included – who concluded that the more long-term debt banking organizations issue, the less they'll lend. Better Markets is also and rightly dubious that LTD insulates regional banks from bailouts, a point we have also made when it comes to GSIBs given the FDIC's failure to execute its prime directive: readiness to close all banking organizations under its own authority or that granted via Dodd-Frank's orderly liquidation authority.

In recent remarks, Vice Chair Barr dangled another offer: lifting the veil on the revised impact analysis for the capital rule. However, Mr. Barr also said only that banks could see the analysis before the rule is finalized, not touch it by way of formal comments. This odd tactic is another obvious maneuver, this time to get the rule done before the agencies face a challenging Congressional Review Act fight in which victory may depend on the certain Biden veto if both houses pass the repeal resolution, as they both may well come to do.

But, even if the new impact statement is a good deal more credible than the old impact statement – and this remains very much to be seen – releasing a new analysis will only be credible if it comes with express indications of what the analysis tells the agencies and what they now plan to change in the final rule. Tactical errors to date – and they are manifest – mean that the agencies will have a hard time selling this to internal dissenters and outside critics, but it's more than possible that even promises of major concessions without the benefit of a new proposal will not suffice. If the agencies then are forced to rethink the capital and LTD proposals in ways that discomfit them, they've only themselves to blame.