# FedFin Daily Briefing

**Wednesday, March 27, 2024**

## FRB-Cleveland Study: Banks Beat Capital-Rule Reaper

One of the major complaints banks have raised with the pending end-game capital rules is that the proposed transition period for final implementation does not soften the blow as the agencies argue. A new analysis from Federal Reserve Bank of Cleveland staff supports a prior analysis finding that U.S. banks generally hiked regulatory capital after the great financial crisis after it not only became clear that the rules would change in 2009, but also largely before the U.S. proposed revisions following the Basel III standards were released in 2012 – a year before final standards came out and well before compliance was required. There is, though, significant variance in how banks come up to scratch when new capital rules are likely. Larger banks (i.e., those with over $10 billion) started with lower ratios than community banks but on average began to increase Tier 1 capital in 2008 while community banks did not generally do so until 2010. It is not clear from the analysis if capital actions by larger banks in 2008 are calculated with or without the TARP capital infusions that came to larger banks like it or not from the federal government at the height of the crisis, but the averaging approach suggests that regulations apply to larger banks even if distorted by rapid recapitalization at the very largest banks.

## Treasury Points to AI Fraud, Cyber Risk; Presses for New Rules, Best Practices

Adhering to the President's AI executive order (see *Client Report* **AI3**), Treasury today assessed AI risk in the financial sector, concluding that further work is required to address AI-related fraud and cybersecurity risks. The agency's recommendations include greater U.S. regulatory coordination with financial institutions due in part to potential regulatory fragmentation and resulting arbitrage. Treasury also recommends a standardized AI lexicon and a "nutrition label" style description to identify training data, emphasizing the need for accurate data and explicability – a concern recently expressed also by Acting Comptroller Hsu and SEC Chair Gensler. As noted, we expect the banking agencies shortly to update their 2021 AI assessment (see FSM Report **AI**), issuing more prescriptive standards. Treasury also identifies the need for greater data sharing between large and small financial institutions since large firms enjoy advantages due to proprietary AI models, and the report also asks the industry to advance best practices for both generative AI explicability and digital identity solutions. Treasury on its own will continue to work with regulators and private sector groups to address AI-related challenges and synchronize regulatory efforts.

## FRB-NY: Mid-Size Regionals Show Deposit/Asset Recovery

A new report from Federal Reserve Bank of New York staff finds that the 2023 failures had little lasting impact on bank deposit costs and funding practices save for banks between the $50 to $250 billion level the study dubs "super-regionals." This term is usually reserved for non-GSIBs at least above $500 billion, but the regionals covered in this study are indeed those most directly affected by the failures and resulting uninsured-depositor skittishness. Banks in the $50-$250 billion range are found to have raised deposit betas more quickly than other IDIs doubtless to attract continued deposit funding, with this strategy succeeding as these banks also grew interest-bearing deposits relative to the rest of the industry. As a result, the study concludes that covered banks are not under undue earnings or capital pressure, a result they attribute in part to government interventions such as the systemic designation and BTFP. IDIs between $50-$250 billion also grew assets more than other banks, reinforcing this hypothesis. The very largest banks continue to exhibit lower deposit betas than other banks, with this likely due to depositor perception of greater safety.

# KC Fed: Core-System Providers May Have Undue Market Power

A new report from Kansas City Fed staff finds that three core-system providers dominate this critical sector, making it difficult for depository institutions and especially smaller banks to obtain better service levels. This is found to adversely affect their ability to offer new products and thus remain competitive. The study thus catalogs the current competitive framework, noting several emerging core providers but also that possible acquisition as these come to scale by dominant providers could reduce potential market benefits. The study also notes the manner in which dominant providers have become vertically integrated, observing that bank perceptions of poor service and customer dissatisfaction with "unfair" contract terms suggest undue market power. This is an issue flagged in 2022 by CFPB Director Chopra, who questioned core-provider market power and suggested that it adversely affects consumers in numerous ways within his jurisdiction to address. He has not yet done so.

## 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.

- **MERGER15:** Following its 2022 request for input, the FDIC has released a formal proposal that would redefine the agency's bank-merger policy into one that will make it difficult for all but the smallest and simplest transactions within its jurisdiction to have the clear prospects for approval usually necessary in non-emergency transactions, subjecting other M&A applications to protracted review with a high likelihood of denial.

- **REFORM231:** Today's HFSC hearing on global governance featured expected Republican attacks on what they called the opaque nature of U.S. interactions with international organizations, with Chairman McHenry (R-NC) promoting a draft bill requiring regulators to report dealings with global standard-setting groups to Congress.

- **GSIB24:** Reflecting concerns expressed about banks that window-dress key regulatory data as the post-crisis framework took shape, the Basel Committee has now issued a request for views on how to prevent this when it comes to GSIB calculations related to their surcharge or possible designation.

- **CREDITCARD37:** Following a very controversial proposal, the CFPB has finalized credit-card late-fee restrictions in a final rule that does not differ significantly from the proposal on its key point: elimination of the manner in which inflation adjustments are now made by credit-card lenders when it comes to late fees.

- **GSE-031224:** The President's FY25 budget picks up FHFA's recommendations, calling for statutory change to double the System's affordable-housing commitment.

- **FEDERALRESERVE75:** As expected, Republicans took turns grilling Chair Powell on the Basel III endgame proposal and calling for its withdrawal, and were likely pleased with the results.

- **CONSUMER56:** The CFPB has issued a circular essentially banning digital and perhaps all other consumer-finance comparison-shopping and lead-generation tools for credit cards and other products not covered by prior orders.

- **GSE-021624:** In this report, we build on our in-depth analysis yesterday of the Fed's new stress-test scenarios to focus on their mortgage-market impact.

- **STRESS32:** In this report, we assess the strategic and policy implications of the Fed's new stress-test regime.

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