



FedFin Client Report

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Gruenberg Grilled on Both Sides

Client Report: REFORM232

Executive Summary

Democrats today were surprisingly scathing about FDIC Chair Gruenberg's continued service, with Reps. Pressley (D-MA), Velázquez (D-NY), and Foster (D-IL) making clear they had lost confidence in him. Ranking Member Waters (D-CA) tried to pin the blame at least as much on Mr. Gruenberg's predecessors, but Rep. Meeks (D-NY) and others were more focused on Mr. Gruenberg, with Rep. Garcia (D-TX) getting him to agree to anger management training. Republicans were united in blistering statements, with HFSC Chair McHenry (R-NC) closing the hearing by saying that he might convene another hearing solely on the FDIC chair given Democratic concerns about the need to focus more on the FDIC than possible given the overall regulatory agenda. One major focus nonetheless was of course on the end-game rules, with Republicans trying to get FRB Vice Chair Barr to agree that the rule needs to be re-proposed given plans for material changes. Mr. Barr refused to do so or to say when the QIS will be released beyond indicating that it should be in the near term. Mr. Barr also would not outline his view on the new incentive-compensation proposal ([see FSM Report COMPENSATION38](#)) when pressed to do so by Rep. Velázquez. We will defer a forecast of how Mr. Gruenberg is likely to fare until after tomorrow's Senate Banking hearing, which will surely be as tough and may perhaps indicate additional sentiment that Mr. Gruenberg resign. Should he continue to refuse to do so as he did today, it will fall on the White House to dismiss him; we continue to believe the President will do so only if more damning evidence directly linked to Mr. Gruenberg surfaces.

Analysis

Opening Statements

Chair McHenry again called for Chair Gruenberg's resignation and accused him of taking no responsibility for his actions. [Echoing](#) House Oversight Chair Comer (R-KY), Mr. McHenry also referenced President Biden's quote regarding firing people who treat colleagues with disrespect, calling on Democrats and the President to acknowledge that the misconduct identified meets that standard. Ranking Member Waters called the report "deeply troubling," and said that it was clear that FDIC leadership has failed to address "deep-rooted" workplace issues. She also applauded the OCC, FDIC, and FHFA for proposing incentive-compensation restrictions, calling on the Fed to follow suit. The Ranking Member also praised the public

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hearing [scheduled](#) on the CapOne/Discover merger. Financial Institutions Subcommittee Chair Barr (R-KY) called for Chair Gruenberg to resign, noting that the FDIC would not grant the same grace if similar workplace issues were discovered at a bank. He also called for Basel III re-proposal, calling it “fundamentally flawed.” Subcommittee Ranking Member Foster said he is “appalled” by the Cleary report and stated that meaningful actions must be taken to address long-standing personnel issues. He also urged colleagues to take time to fully review the facts of the report.

Testimony

While Vice Chair for Supervision Barr and FDIC Chairman Gruenberg's [testimony](#) summarized their written statements, Acting Comptroller Hsu's oral testimony diverged from his written [remarks](#), specifically defending Mr. Gruenberg even as he pointed to ongoing efforts to reform FDIC workplace practices.

Q&A

- **Basel III Re-Proposal:** Amid calls from fellow Republicans to scrap and re-propose the capital proposal, Vice Chair Hill (R-AR) noted that the courts have previously invalidated agency rulemakings where the final rule was not considered a “logical outgrowth” of the proposed rule. Rep. Hill asked if the agencies have agreed not to re-propose. All three witnesses stated that they have not come to agreement, with Vice Chair Barr noting that they are still focused on content rather than process. Reps. Barr and Meuser (R-PA) asked for a timeline regarding the release of the Quantitative Impact Study; Vice Chair Barr replied that the QIS will be released “relatively soon” and is in the review process.
- **Nonbank Mortgage Companies:** Rep. Foster asked about the financial stability concerns identified in FSOC’s recent nonbank mortgage company [report](#); Mr. Hsu replied that the nonbank mortgage servicing industry is relatively concentrated and disruptions could be damaging due to severe contagion risks to the GSEs and the banking system. Rep. Foster asked about the market shifting away from banks and towards nonbanks; Mr. Hsu replied that regulators want standards to be applied equally and appropriately inside and outside the banking system. Rep. Foster and Vice Chair Hill asked about the FSOC report’s suggestion for an industry fund Mr. Hill also called a “bailout fund.” Vice Chair Barr acknowledged the recommendation and disagreed with Mr. Hill’s description.
- **Debit-Card Interchange Fees:** Rep. Scott (D-GA) expressed concerns that lowering caps on debit interchange fees would hinder banks’ ability to offer low-cost and no-cost bank accounts to LMI Americans, also stating concerns regarding the proposal’s impact on small business owners. Vice Chair Barr said the Fed is reviewing comments on the proposal ([see FSM Report INTERCHANGE12](#)).

- **LTD Proposal:** Rep. Timmons (R-SC) noted that the LTD proposal is based on current capital levels, asking Chair Gruenberg if the LTD rule should be postponed until there is greater certainty regarding the Basel III proposal. Mr. Gruenberg said that the LTD proposal was developed independently, and he does not link the two rules. Rep. Williams (R-TX) said the LTD proposal's six percent threshold of risk-weighted assets is too high for regional banks considering their risk profiles and could hinder competition and innovation in the financial system; Mr. Barr replied that the agencies are considering the right calibration of the threshold and are working through comments.
- **Climate Stress Tests:** Rep. Casten (D-IL) asked about the data challenges banks have monitoring physical risks identified in the report on the Fed's pilot climate scenario analysis. Mr. Barr replied that banks are in the early stages of managing climate risk, and noted that the losses a bank would take would be related to the availability of insurance coverage. Rep. Casten stated his desire to work with regulators as necessary should insurers continue to exit high-risk states and banks look for a way to offload risk.
- **Merger Policy:** Noting the size-gap between GSIBs and even the largest proposed bank mergers, Rep. Davidson (R-OH) expressed concerns that the OCC's merger proposal imposes an "artificial cap" on merged bank size; Mr. Hsu disagreed, stating that mergers that fulfill statutory factors will be approved and no artificial cap exists.
- **Check Fraud:** Rep. Timmons also warned against rising check fraud, specifically duplicate presentment fraud, and asked if the Fed would consider operationalizing its duplicate check notifier service or other technologically-driven solutions. Vice Chair Barr agreed that check fraud is a significant problem and stated that the Fed is looking at ways to help while working with banks and supervisors.
- **Regulatory Capture:** In addition to Rep. Velazquez's comments on the Fed's implementation of Section 956, Rep. Tlaib (D-MI) suggested regulatory capture as part of the reason the Fed won't move forward with executive-compensation, suggesting the Fed is captive to the banking industry. Mr. Barr replied that board members of the regional banks play no supervisory role and that representatives from banks are on Reserve Bank boards as required by law.
- **Index Fund Ownership:** Rep. Garbarino (R-NY) asked if all three agencies had discussed the potential negative impacts of changes to passivity agreements; Mr. Hsu replied that the agencies have different views on how to proceed, with the FDIC unable to agree on possible approaches ([see Client Report ASSETMANAGEMENT8](#)).
- **GSIB Methodology:** Rep. Garbarino also asked Vice Chairman Barr why the GSIB surcharge proposal ([see FSM Report GSIB22](#)) does not consider the method for GSIB surcharge calculation; Vice Chair Barr replied that the Fed is looking at methodological

recommendations in the comments received.

- **Tokenization:** Rep. Lynch (D-MA) asked if it is possible to tokenize any security, and if tokenized securities could upend the traditional securities system. Mr. Hsu stated that upending the traditional securities system is a possibility if tokenization is not done correctly, while also cautioning against using the term “tokenization” too loosely.