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Potomac Perspective

The Federal Reserve (Fed)'s post-mortem on Silicon Valley Bank includes suggestions about future changes in regulations for banks above $100 billion in assets. The possible changes would be implemented over time and are generally in line with previous expectations about what the future will hold for large regional banks. However, Fed Vice Chairman Michael Barr's letter also signals a possible shift in supervision, which could be applicable to banks of all sizes.

Earlier today the Federal Reserve Board released a report regarding the failure of Silicon Valley Bank (SVB). The document is approximately 100 pages long and provides an in-depth look at the failure of the bank and the deficiencies of supervisory actions over the past few years. Click here to access the Fed's report.

In addition to the look back, the report also includes **suggestions of possible future revisions to regulations** that could roll back many of the changes that the Fed made in 2019 (the Tailoring Rule) following the passage of S. 2155 (the Crapo bill). These possible regulatory changes were already telegraphed and are mostly consistent with expectations. Future alterations would go through the "notice and comments" process, could be phased in over time, and would likely be targeted at banks above $100 billion in assets.

Notably, and possibly unexpected to the industry and investors, Federal Reserve Vice Chairman for Supervision Michael Barr's letter preceding the report includes **a recommendation that bank supervisors be empowered to act more quickly to address capital and liquidity issues. Vice Chairman Barr does not seem to limit this recommendation to banks above $100 billion in assets, and it is possible that it could be applied to banks of all sizes. Furthermore, this recommendation addresses a supervisory issue which might not necessarily be subject to the notice and comment process and could therefore be implemented more rapidly.**

> *Once (supervisory) issues are identified, they should be addressed more quickly, both by the bank and by supervisors. Today, for example, the Federal Reserve generally does not require additional capital or liquidity beyond regulatory requirements for a firm with inadequate capital planning, liquidity risk management, or governance and controls. We need to change that in appropriate cases. Higher capital or liquidity requirements can serve as an important safeguard until risk controls improve, and they can focus management's attention on the most critical issues. As a further example, limits on capital distributions or incentive compensation could be appropriate and effective in some cases.*

The report includes the following suggestions for changes in bank regulation that will likely be targeted at banks over $100 billion in assets:

- Annual stress testing;
- Resolution planning (living wills);
- Reflect Accumulated Other Comprehensive Income (AOCI) in regulatory capital;
- Requiring full compliance with liquidity rules; and
- Subject these banks to the Supplementary Leverage Ratio and Countercyclical Capital Buffer; and
- Total loss-absorbing capacity requirements.

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The timing and details of how these changes would be implemented were not mentioned in the report, but it is reasonable to expect that regulatory proposals will be forthcoming within the next few months with various phase-ins in order to avoid procyclical impacts, especially if the economy starts to soften going into 2024.

Next up: The Federal Deposit Insurance Corporation (FDIC) is scheduled to issue a report on Monday, May 1, regarding deposit insurance. The FDIC report is expected to include policy options for Congress, but in the current environment, the probability of Congress passing deposit insurance legislation is low. This could be a multi-year endeavor. **Sometime later in May, the FDIC is also expected to propose a special assessment to cover the losses for covering uninsured deposits at SVB and Signature Bank.** A special assessment is likely to be targeted at banks over $100 billion in assets and could be assessed over several years to smooth out the impact to banks assessed by the FDIC.

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