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WASHINGTON POLICY STRATEGY

Potomac Perspective

In today's note, we look at how the Department of Justice (DOJ)'s approach to bank mergers is apparently changing and could slow down the merger application process. Relatedly, Federal Reserve (Fed) Chairman Jerome Powell testifies before Congress this week. Bank regulation and bank mergers could be a popular topic in Q&A.

The Senate Banking Committee is scheduled to vote on a compromise regarding executive compensation clawbacks.

Finally, Congress is starting to look at AI and how to regulate the technology. Despite the rush to engage on the topic, it could take Congress a long time to legislate.

DOJ ON BANK MERGERS

On Tuesday, Assistant Attorney General (AG) Jonathan Kanter spoke at the Brookings Institution about bank merger enforcement policy. Of note, Assistant AG Kanter indicated that **the DOJ will take a more granular approach when it reviews bank mergers. DOJ's new approach could offset efforts by banking regulators to normalize the time it takes the agencies to review bank merger applications.**

In its review of bank mergers, the DOJ prepares a "competitive factors" report which has historically focused on deposit share and branch concentration. Going forward, the DOJ "will assess the relevant competition in retail banking, small business banking, and large- and mid-size business banking in any given transaction. These analyses will include consideration of concentration levels across a wide range of appropriate metrics and not just local deposits and branch overlaps." Mr. Kanter did not explain what methodology the DOJ would employ in assessing competition in these markets, nor did he indicate when the DOJ and the bank regulatory agencies might propose formal changes in their respective Bank Merger Guidelines, a review of which has been ongoing since late 2021. The expansion of the factors the DOJ will examine seems likely to extend the DOJ's review process and possibly lengthen the time it takes for regulators to rule on a merger application.

Banking regulators at the Federal Reserve Board, the Office of the Comptroller of the Currency, and Treasury Secretary Janet Yellen have signaled support – and even some encouragement for bank mergers (except for the global systemically important banks). In the wake of the failures of three regional banks (Silicon Valley Bank, Signature Bank of New York, and First Republic Bank), there has seemingly been an acknowledgement among regulators that the acquisition of a weak bank by a stronger bank is good public policy and is preferable to the resolution of the weak bank by the Federal Deposit Insurance Corporation (FDIC). This has led some to believe that recent delays in the merger application process at the agencies might be a thing of the past. While that may be true, Mr. Kanter's speech suggests that a more in-depth and potentially time-consuming review by the DOJ could offset any effort by the banking regulators to normalize their process. The Kanter speech suggests a longer and more in-depth review of bank mergers by DOJ than has been the case since the current Bank Merger Guidelines were written in 1995.

POWELL ON THE HILL

Fed Board Chairman Jerome Powell starts two days of congressional testimony today. The semiannual Humphrey Hawkins hearings used to be a big deal for markets, but regularly scheduled press conferences following Federal Open Market Committee meetings have diminished the market impact of these hearings.

While the hearings are nominally about monetary policy, in the wake of the recent bank failures many of the questions are expected to focus on banking regulation. Chairman Powell has developed a talent for avoiding the possible front running of upcoming Fed regulatory actions, but he could shine some light on the timing of changes in the tailoring rules which were implemented in 2019 (including some changes in bank capital requirements) as well as proposals to change bank merger rules.

BANK CLAWBACK LEGISLATION

The Senate Banking Committee is scheduled to markup legislation today that would give more authority to banking regulators to clawback compensation from executives of failed banks. The bill, which was negotiated by committee chairman, Senator Sherrod Brown (D-Ohio), and the ranking Republican member, Senator Tim Scott (R-South Carolina) would empower the FDIC to clawback bonus and discretionary compensation, but not salary, from executives of failed banks. The legislation gives the agency more authority but does not compel clawbacks.

A unique, bipartisan group of senators on the committee, led by Senators Elizabeth Warren (D-Massachusetts) and J.D. Vance (R-Ohio) will push for more aggressive clawback provisions. **The Warren approach could be a poison pill that upsets the compromise reached between Senators Brown and Scott. While the Warren alternative might have surprisingly strong support, it is likely to be defeated in order to preserve a compromise that can possibly pass both chambers.** Furthermore, Senator Brown faces a tough reelection campaign in 2024, and some Democrats who might be otherwise supportive of Senator Warren's approach could reject the Warren amendment in order to increase to chances of giving Senator Brown a legislative win ahead of his reelection campaign.

VERY EARLY DAYS FOR AI REGULATION

In the wake of market and media attention given to artificial intelligence (AI), Washington is ramping up its focus on the sector. However, **despite the increased attention that Washington has been and will give to the expansion of AI, it will probably take Congress and regulators years to regulate the industry.**

Investors and market participants should look to cryptocurrency and other emerging technologies and products as examples of where policymakers have expressed a desire to regulate a business in order to protect the public from the possible downsides of the new technology. With cryptocurrency, calls from the industry for regulation started in 2012 and Congress has still yet to pass legislation.

In recent years, agencies such as the Securities and Exchange Commission and the Commodities and Futures Trading Commission have stepped in to fill the void by pursuing enforcement actions that establish some parameters for regulation, albeit without total clarity. In antitrust, old rules do not easily apply to modern technologies, but efforts in Congress to establish new rules for social media and tech have floundered.

There is, undoubtedly, bipartisan interest on Capitol Hill is addressing AI. However, the challenges of educating Members of Congress on a technology that few of them truly understand, coupled with the even greater challenge of reaching a consensus on how the government should regulate AI, could make this a potentially decade-long effort.

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