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Potomac Perspective

Today the Federal Reserve (Fed)'s new Vice Chair for Supervision, Michelle Bowman, gave her first speech since being confirmed earlier this week by the Senate. The speech reflected much of what Vice Chair Bowman has said as a Fed Governor, so there wasn't much new. Still, the speech was a positive for the banking industry. Here are a few quick takeaways.

- **Enhanced Supervision** – Fed Vice Chair for Supervision (VCS) Bowman's first speech since her Senate confirmation lead with "Enhanced Supervision," in which she said the Fed's *"goal should be to prioritize the identification of material financial risks and encourage prompt action to mitigate risks that threaten safety and soundness."*
  - In this vein, she mentioned tailoring, which is something we thought she would prioritize. She did not specifically mention changing the $100 billion threshold for larger banks, but that could be on the table in the near future — essentially "re-tailoring" the tailoring rules. She did not mention changes to Accumulated Other Comprehensive Income rules, which could be one of the more controversial issues the Fed considers as part of this process.
  - She expressed frustration (my word) with thresholds for smaller banks. *"It is clear that the current $10 billion threshold defining the upper bounds of a "community bank" leaves many institutions that pursue this business model—of community and relationship-based banking—subject to heightened requirements more suitable for larger and more complex firms."* Bowman said she will hold a conference later this year on small and community bank issues. Thresholds of $10 billion and $20 billion are written into the Dodd-Frank Act, and regulators are limited in what they can do with them, especially given recent Supreme Court decisions that have curtailed the discretion and flexibility of regulatory agencies.
  - **Ratings** — She mentioned *"that two-thirds of the largest financial institutions in the U.S. were rated unsatisfactory in the first half of 2024. At the same time, the majority of these same institutions met all supervisory expectations for capital and liquidity."* Once addressed, this should open the door to increased large regional bank mergers. We should note this level of negative ratings conflicts with public statements from Fed officials and the Biden administration's Treasury Department that the industry was healthy. If the industry is, in fact healthy, the ratings are wrong. Two-thirds of a top-heavy banking system having negative ratings is incompatible with a healthy industry.
- **Capital**
  - She signaled an interest in changing the enhanced supplementary ratio which makes the largest banks, which are subject to the Supplementary Leverage Ratio (SLR), *"less inclined to engage in low-risk activities like Treasury market intermediation and revise their business activities in a way that is neither justified nor responsive to their*

customer needs." This is part of the broad Trump administration's agenda, i.e., change the SLR requirements with the goal of increasing demand for Treasuries. The goal of this action would be to generate another source of demand which could restrain the federal government's interest payments, especially at a time when the foreign appetite for U.S. Treasuries is questionable due to the tariff situation.

  - Vice Chair Bowman said she is open to discussing changes to stress testing, the global systemically important surcharge, and the Basel III capital requirements, though she gave no details about her policy preferences.

- **Bank Applications**
  - She said that *"Recent experience with banking applications suggests that revisions would be helpful"* and specifically mentioned merger and *de novo* applications. Re: bank mergers, she clearly wants to make the process more efficient and specifically mentioned *"the perverse effect of 'competitive' screens that disproportionately affect transactions in rural and underserved banking markets."* She also questioned the value of public comments to a merger application that lack factual support.

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