THORN RUN PARTNERS GOVERNMENT RELATIONS

Hearing Summary

December 7, 2023

SENATE BANKING HOLDS ANNUAL WALL STREET OVERSIGHT HEARING

EXECUTIVE SUMMARY

On December 6, the Senate Banking Committee held a hearing entitled "Annual Oversight of Wall Street Firms." During the hearing, lawmakers heard testimony from the chief executives of the nation's largest banks who sought to update the panel on various undertakings at their respective institutions. Notably, all of the executives expressed strong opposition to regulators' Basel III Endgame capital proposal, arguing that it will restrict lending to consumers and small businesses, as well as potentially push more banking activity into the nonbank sector.

Committee Republicans sided with bank executives in their opposition to the capital proposal, agreeing that it would restrict lending. They also argued that the proposal is "significantly" more stringent than Basel III harmonizing efforts in other countries, suggesting that this may place U.S. financial institutions at a competitive disadvantage. Conversely, Democrats on the panel argued that the proposal is needed to ensure financial stability going forward and criticized the notion that it may restrict lending. Lawmakers also expressed interest in how banks are addressing the illicit financing of terrorist organizations and hostile state actors, among other topics.

OPENING STATEMENTS

Chair Sherrod Brown (D-OH) (statement) argued in support for bolstering capital requirements to prevent future bank failures, taking specific criticism over the banks' public messaging campaigns on the issue. Additionally, he called for passage of the Recovering Executive Compensation from Unaccountable Practices (RECOUP) Act (S.2190) to ensure accountability from the executives of failed banks.

Ranking Member Tim Scott (R-SC) (statement) criticized regulators for what he characterized as a series of overly burdensome regulation, specifically calling attention to the Basel III proposal. He echoed broad Republican sentiment that the proposal would result in lower credit availability and decreased small business lending.

WITNESS TESTIMONY

Mr. Charles Scharf (testimony), of Wells Fargo, emphasized Wells Fargo's role in maintaining banking sector stability during a crisis, highlighting the bank's strength, simplified business model, and domestic focus. He outlined his bank's customer service improvements, community impact initiatives, and investments in employees, including wage increases and development programs.

Mr. Jamie Dimon (testimony), of JP Morgan Chase, praised the U.S. financial system's resilience, highlighting JPMorgan Chase's role in supporting the economy with its branch network, credit provision, and global financial services. He expressed concerns about the Basel III Endgame proposal, warning of its potential adverse effects on mortgage access, small business loans, and various sectors and emphasizing the need for thoughtful regulation to maintain a robust banking system.

Ms. Jane Fraser (testimony), of Citigroup, touted the strength and stability of the U.S. banking system, praising the industry's collaboration during recent isolated bank failures. She highlighted the role of banks, including Citigroup, in supporting economic growth, providing financial services, and promoting financial inclusion, while expressing concerns about the Basel III Endgame requirements' potential adverse impact on lending, particularly for smaller companies and consumers.

Mr. Ronald O'Hanley (testimony), of State Street, emphasized that State Street is not a consumer bank but rather focuses on investment servicing and investment management. He underscored the importance of custody banks in ensuring the safety and security of investor assets, expressing concerns about regulatory proposals that could impact the industry's ability to provide low-cost and secure services.

Mr. Robin Vince (testimony), of BNY Mellon, voiced his institution's commitment to a strong and competitive banking system. He discussed the importance of resiliency, both in terms of financial strength and operational preparedness, while underscoring the significance of technology, innovation, and his company's dedication to its employees, including through equity ownership initiatives.

Mr. David Solom (testimony), of Goldman Sachs, discussed the strength and resiliency of his firm's balance sheet, expressed concerns about the Basel III Endgame capital rules, and argued that the proposal — particularly its increased capital requirement for market-making activity — could negatively impact the competitiveness of U.S. banks, increase costs for various sectors, and potentially harm the overall stability of the financial system.

Mr. James Gorman (testimony), of Morgan Stanley, highlighted the resilience of the banking system and impact of regulatory reforms since the 2008 financial crisis. He expressed concerns about the proposed Basel III Endgame capital requirements, arguing that additional increases for large U.S. banks are unnecessary and could make credit more expensive and less accessible, as well as harm the competitiveness of the U.S. economy. Mr. Gorman also highlighted Morgan Stanley's role in advising businesses, managing assets, and contributing to economic growth, while emphasizing the importance of finding a balanced approach to regulation.

Discussion and Questions

Basel III Proposal

- Chair Brown pressed witnesses on whether they believed their banks would be capable of meeting the proposed increase in capital requirements under the Basel III Endgame proposal, to which witnesses indicated that they could.
- Ranking Member Scott echoed his fellow Republican colleagues in asking whether they could do so without adversely affecting the economy. Mr. Scharf noted that he has concerns the proposal would either require his bank to increase the price of lending or reduce its lending altogether. Mr. Moynihan agreed with this sentiment while Mr. Dimon suggested that the Ranking Member's question should have been asked prior to the proposal. Ms. Fraser argued that the proposal would also increase borrowing costs for farmers and impact their ability to hedge their products using derivatives, which she later reiterated in questioning with **Sen. Cynthia Lummis (R-WY)**. In similar questioning with **Sen. Bill Hagerty (R-TN)**, Mr. Dimon asserted that the proposal will diminish mortgage origination.
- **Sen. Jon Tester (D-MT)** asked Ms. Fraser if she is concerned that the Basel III Endgame proposal will result in more banking activity shifting to the nonbank sector. Ms. Fraser acknowledged these concerns and asserted that the proposal may "undermine" the strengths of the U.S. financial system.
- **Sen. Thom Tillis (R-NC)** asked Mr. Gorman to comment on whether the Basel III Endgame proposal will impact operational risk, to which Mr. Gorman expressed opposition to the notion of "punishing" institutions for operating fee-based businesses.
- Sen. Tillis wondered if the pension industry should be concerned about Basel III's impact on security financial transactions (SFT). Mr. Solomon asserted that the increased capital requirements under the proposal would make SFTs uneconomical for banks and thus eliminate the ability for pension funds to engage in such transactions.
- Sen. Tillis asked if it is possible for banks to "game" Comprehensive Capital Analysis and Review (CCAR) stress testing, alluding to claims made by regulators. Witnesses suggested that this is not possible. Mr. Dimon characterized the stress tests as a "black box" that is costly to comply with, adding that banks conduct their own stress tests on a regular basis.
- **Sen. John Kennedy (R-LA)** questioned the legality of regulators' Basel III Endgame proposal on the grounds that it came at the direction of the Basel Committee rather than Congress. Ms. Fraser welcomed this view, adding that, while it would be a last resort, banks would be willing to examine whether the proposal violates the law.
- While he acknowledged that he has reservations regarding Basel III, **Sen. Mark Warner (D-VA)** was critical of banks for not utilizing the Fed's discount window, questioning whether its utilization should to some extent be mandatory. Mr. Moynihan noted that the largest banks are required to be prepared to access the discount window but acknowledged that the industry as a whole is reluctant to utilize it due to its perception by markets. Sen. Warner indicated that he intends to introduce legislation to require usage of the discount window.
- **Sens. Katie Britt (R-AL)** and Hagerty questioned how the Basel III proposal would impact the competitiveness of U.S. financial markets globally. Mr. Solomon argued that the Basel III harmonization proposals being adopted in other countries are less stringent than that of the U.S., contending that it would place U.S. financial institutions and markets at a disadvantage.
- **Sens. Steve Daines (R-MT),** Lummis**,** and Britt prompted Mr. Moynihan to explain how the proposed increase in capital requirements could "trickle down" to smaller community banks.

Mr. Moynihan explained that the larger banks often offer services to smaller community banks and that the increased capital requirements would result in smaller banks paying more for these services.

- **Sen. John Fetterman (D-PA)** questioned whether banks could be taken at their word that they can avoid situations such as the bank failures earlier this year without regulatory action. Mr. Moynihan pointed out that the Basel III proposal would not have captured Silicon Valley Bank (SVB). Mr. Dimon agreed with this characterization and encouraged regulators to address interest rate risk exposure.
- Sen. Lummis expressed concern over Basel III's use of public listings for counterparty credit risk in derivatives and how it may impact mutual fund investors. Mr. O'Hanley suggested that it is a "crude" measure of risk.

Cybersecurity, AML, and Illicit Finance

- Sen. Tester pressed witnesses on what their banks are doing to ensure that are not inadvertently funding illicit activities. Mr. Gorman noted that Morgan Stanley has substantially increased spending on cybersecurity and that they work closely with intelligence officials and law enforcement. He added that their anti-money-laundering (AML) focusses on validating the identity of the senders of funds, adding that artificial intelligence (AI) may assist in these efforts.
- Sen. Tester asked Mr. Scharf what Wells Fargo is doing to ensure it does not facilitate sanctions evasion. Mr. Scharf explained that they work with government officials to ensure this does not happen.
- **Sen. Elizabeth Warren (D-MA)** prompted witnesses to disclose whether they have the infrastructure in place to detect and report illicit terrorist financing. All witnesses indicated that they did. Sen. Warren asserted that terrorist organizations and hostile state actors are using digital assets to finance their activities. Mr. Dimon alleged that the only use cases for digital assets involve nefarious activities.
- Sen. Warren asked witnesses if they believed digital asset companies should be subject to the same AML statutes that traditional banks do. All witnesses agreed that digital asset companies should be subject to the same AML laws. Sen. Warren encouraged support for her legislation that would extend AML regulations to digital asset firms.

Macroeconomic Conditions

- **Sen. Mike Rounds (R-SD)** asked what risk rising indebtedness poses to the U.S. economy. Mr. Solomon agreed with the concern over rising U.S. debt, noting that the cost of financing the debt will continue to rise as well. He also suggested that failure to address this issue will likely facilitate increased volatility in U.S. Treasury markets.

Housing

- **Sen. Catherine Cortez Masto (D-NV)** raised the prospect of requiring Federal Home Loan Banks (FHLB) to increase their share of revenue devoted to affordable housing from 10 percent to 20 percent. All witnesses agreed that 20 percent would be feasible. Further, Sen.

Cortez Masto suggested tying the FHLBs' dividends and advances to its missions activities conducted by financial institutions.

- Sen. Cortez Masto referenced the Federal Housing Finance Agency's (FHFA) recommendation that 10 percent of all institutions' assets should be held in housing and asked if any of the witnesses' banks would invest more in housing to retain access to FHLB funding. Mr. Moynihan contended that under the Basel III proposal, banks will have to shrink the size of their on-balance-sheet mortgage portfolio, which would in turn reduce their eligibility for FHLB loan access. He added that making mortgages more capital intensive under Basel III makes holding the mortgages on a bank's balance sheet less profitable, potentially shifting more mortgage activity outside the traditional banking sector.
- **Sen. Tina Smith (D-MN)** asked whether the revised Community Reinvestment Act (CRA) rulemaking will better help banks in meeting their obligations under the CRA. Mr. Scharf offered his support for the CRA's intent but noted that Wells Fargo has offered regulators some areas they believe should be revisited. Further, Sen. Smith questioned whether it would be prudent for regulators to revisit the CRA periodically to ensure it is still achieving its intended goal. Mr. Scharf agreed that it should be periodically reexamined.
- **Sen. Raphael Warnock (D-GA)** asked witnesses if they would support efforts to increase equity for minority communities under the CRA. Witnesses supported the sentiment but noted that they would like to evaluate any proposal before committing to it.

Other Topics

- Chair Brown asked whether the banks actively check military databases to see if veterans are eligible for lower interest rates. Witnesses indicated that they follow the law but will check on the specifics surrounding the issue.
- Chair Brown pressed witnesses on whether they support a proposal to increase asset limits under the Supplemental Security Income (SSI) program. Mr. Dimon offered his support for the proposal, claiming that certain employees do not want increased salaries because it would result in them being ineligible for SSI. Mr. Scharf offered to examine the proposal more closely. The remaining witnesses indicated that they support the proposal.
- **Sen. Jack Reed (D-RI)** asked witnesses whether they would support expanding the 36 percent interest rate cap under the Military Lending Act (MLA) to all consumers. Mr. Scharf expressed concerns over setting a cap without understanding the consequences. Mr. Moynihan informed him that Bank of America does not engage in *[sub]*prime lending but that he supported the intent, echoing comments from the remaining witnesses. Mr. Dimon also noted that JP Morgan does not engage in such lending, adding that he is supportive of the intent and the need to crack down on payday lending. Mr. Gorman offered his support, expressing his disapproval of charging interest rates that high.
- **Sen. Bob Menendez (D-NJ)** pressed witnesses on how much money their banks had returned to consumers at the direction of the Consumer Financial Protection Bureau (CFPB). However, the witnesses were unable to provide an answer.
- Sen. Menendez prompted Ms. Fraser on whether her bank was still profitable since abandoning the use of overdraft fees. Ms. Fraser confirmed that Citi is still profitable. Sen.

Menendez suggested that overdraft and insufficient funds fees disproportionately impact minority consumers.

- Citing concerns over a pending case before the Supreme Court on the CFPB's constitutionality, Sen. Menendez questioned whether banks would engage in mortgage lending absent the CFPB's qualified mortgage lending safe harbor rule. Witnesses indicated that they would likely still engage in mortgage lending but noted that it depends on the specifics of the ruling.
- Sen. Menendez asked how policymakers and banks could ensure consumers maintain access to banking services. Mr. Moynihan stated that it is important to increase the use of mobile banking services in low-and-middle-income (LMI) communities, citing encouraging progress in this regard.
- Sen. Warner proposed the notion of granting the Financial Stability Oversight Council (FSOC) jurisdiction over the use of AI in the financial industry. Ms. Fraser encouraged the use of existing regulation to address potential financial risks posed by AI.
- **Sen. Chris Van Hollen (D-MD)** prompted witnesses to comment on whether the higher interest rate environment was negatively weighing on their decisions to support Community Development Financial Institutions (CDFI) or Minority Deposit Institutions (MDI). Mr. Scharf indicated that the interest rate environment does not affect his bank's decision to invest in CDFIs or MDIs while Mr. Moynihan noted that Bank of America has increased such investments.
- Sen. Van Hollen asked if banks were planning to adopt the Fed's FedNow near-instant payment infrastructure, to which the panel explained that each of their institutions plan to join the system.
- Sen. Van Hollen prompted Mr. Dimon on whether he agreed that the carried interest loophole should be "closed." Mr. Dimon agreed.
- **Sens. J.D. Vance (R-OH)** and Daines expressed their opposition to banks' involvement in energy policy.
- Referencing certain issues with generative AI bots such as Binge and Google, Sen. Smith asked Mr. Solomon to comment on how he sees the technology being utilized. Mr. Solomon contended that it can be used to increase worker productivity and efficiency, but cautioned that the right protections should be put in place to mitigate any negative effects. Ms. Fraser added that Citi has successfully used AI technology in a way that maintains human control over the technology and insight into the algorithms that drive its decision making.
- Sen. Warnock asked whether witnesses supported the SAFER Banking Act, noting support from trade associations that the banks are members of. Mr. Moynihan opined that all witnesses likely supported the intent of the legislation but believed it may not properly address the issue. However, other witnesses did not respond to the question, alluding to agreement with Mr. Moynihan's statement.
- **Sen. Laphonza Butler (D-CA)** pressed Ms. Fraser on how Citi ensures its AI technology is not wrongfully closing customer accounts and that consumer's credit will not be impacted as a result. Ms. Fraser explained that there are instances in which AML dictate an account must be closed but offered to follow up on how they assist customers impacted by this.