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Regulators want midsize banks to raise their debt levels to cover losses in case they fail

Article

The news: Proposals unveiled jointly by the Federal Deposit Insurance Corp. (FDIC), the Federal Reserve, and the Office of the Comptroller of the Currency (OCC) would **add more**

oversight of midsize banks and require them to prepare better for potential failures.

- The regulatory plans align closely with what FDIC Chair Martin Gruenberg told us was in the works back on August 14th, when he spoke at the Brookings Institution.

The problem: During the regional banking crisis earlier this year, t**he FDIC paid out over $30 billion from the Deposit Insurance Fund to cover insured deposits—as well as uninsured deposits** that it backstopped after invoking the systemic risk exception.

- Gruenberg said he believes that if the proposed long-term debt requirement had been in place, the debtholders would've borne a major portion of those costs—sparing US banks the special assessment charges now being levied against them.

What's changing: Generally speaking, the proposal takes measures that apply to global systemically important banks (GSIBs) down to the level of regional or midsize banks with at least $100 billion in assets, like **PNC, Capital One, Truist, M&T, Fifth Third, Regions,** and **Northern Trust.**

Here, we highlight the two most important measures:

Hypothetical resolution plans: The FDIC based its recommendations for "living wills" on its nail-biting experiences in winding down **Silicon Valley Bank, Signature Bank,** and **First Republic Bank** over successive weekends.

- It would mandate banks with $50 billion or more in assets to periodically submit plans that outline how they'd operate as bridge banks and be resolved in the event of a failure.
- That includes making their parts separable, so that the various major businesses can be broken up for resale without destroying all of their value.
- Currently, there are 45 insured depository institutions with at least $50 billion in total assets and 31 over $100 billion, according to the FDIC. As a group, the firms represent approximately $13.8 trillion in total deposits, the regulator said.

The FDIC passed this measure with a 3-2 vote.

Long-term debt requirements: Phased in over a three-year period, these would require banks with as little as $100 billion in assets to issue enough long-term debt to cover capital losses in times of severe stress.

- Midsize banks would have to maintain a minimum amount of eligible long-term debt equal to 3.5% of average total assets or 6% of risk-weighted assets, whichever is higher.
- That means these banks would need to issue around $70 billion in new debt.
- They'll be discouraged from holding the debt of other lenders to reduce contagion risk.
- Midsize banks have recently maintained roughly 75% of the required amount of long-term debt outlined in the proposal, according to the FDIC's estimates.

This measure was unanimously passed by all five FDIC members.

Regulators will accept comments on these proposals through the end of November.

Our take: Instead of custom-tailoring regulation for regional and midsize lenders, the Fed and the FDIC are trying to fit them into the framework previously designed for the largest globally active banks. The agencies' acknowledgment that the requirements will create "moderately higher funding costs" for this banking sector doesn't take into account other pressures it's also currently experiencing.

- The move will force some lenders to either issue more corporate bonds or replace existing funding sources with more expensive forms of long-term debt.
- That could further depress midsize banks' earnings after all three major ratings agencies recently downgraded the credit ratings of some within the sector. Per Morgan Stanley analysts, they could see an annual hit to earnings of as much as 3.5%.