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Regional US banks face regulations and EU banks face capital reviews ahead of a hard winter

Article

The news: Regional banks in the US and big banks in the EU face increased regulation and calls for higher capital reserves as a global recession sets in.

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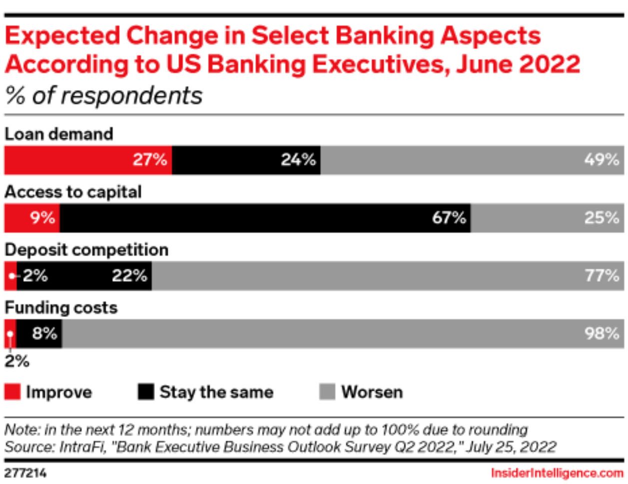
In the US: Anonymous sources have said regulations may be in the works that will require regional banks to increase their long-term debt to absorb potential losses in the event of an economic crisis, according to a Wall Street Journal report.

- The legislation would likely come from the Federal Reserve Board, which would require regional banks' debt levels be proportional to the levels set for the country's largest banks.
- The speculation about legislation was likely spurred by Fed Vice Chair Michael Barr's remarks that because of these regional banks' growth, they're having a greater impact on the stability of the whole financial sector.
- Notable affected banks include U.S. Bank, Truist, and PNC.

Industry trade groups are reportedly ready to push back on any regulation. Members of the Bank Policy Institute pointed out that the regulatory benefits are negligible compared to the cost to financial institutions and their customers.

Barr also hinted that capital reserve requirements may rise for larger banks, too. He acknowledged that they are currently strong, but also questioned if they are strong enough to weather a financial downturn.



In the EU: The European Central Bank (ECB) said that while eurozone banks have built up strong reserves over the past few years, and lenders stand to benefit from rising interest rates, they still must deal with a looming recession and astronomical energy prices.

- The ECB says banks should focus on their exposure to the energy sector and other sectors that are affected by the ongoing energy crisis.

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- The central bank advised banks to review severe and adverse scenarios and engage in dialogue with the ECB on how to best handle the situation.

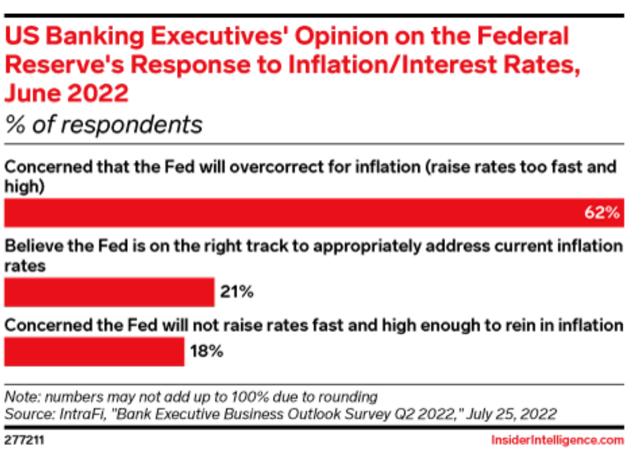
Too medium-sized to fail: In June, after conducting its annual stress tests, the Fed concluded that banks are well positioned to weather a severe economic recession. The tests covered 34 banks and the Fed said the tests the banks underwent simulated the most extreme scenarios.

- But calls for tighter regulations on regional banks began as early as April, when Office of the Comptroller of the Currency (OCC) acting Comptroller Michael Hsu floated the idea that regional banks should create failure plans at the same level as mega banks.

Running out of energy: Across the EU and the UK, banks are being warned to prepare for the worst as citizens brace for an 80% increase in energy bills as Russian retaliations to sanctions continue.

- The central bank has urged banks to assess the impact of a complete gas stoppage.
- ECB President Christine Lagarde said the central bank is “ready to provide liquidity to banks, not to energy utility firms.”

The big takeaway: Banks have been put in a confusing position. Their reserves appear to be strong, central banks globally are dialing up interest rates to rein in inflation, and the ECB is offering liquidity. Increased regulations just increase costs for banks and consumers, which seems to contradict their intent. Non-mega regional banks facing these costs might turn to mergers with each other to create efficiencies and help absorb some of these expenses.



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