US financial regulators concerned about another crisis

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On the surface at least the global financial system appears relatively stable.

Stock markets have reached record highs, official inflation numbers are coming down, interest rates may soon start to fall, problems associated with commercial real estate debt have yet to materialise in any significant way, the price of bitcoin is hitting record highs, and potential sources of a crisis have been contained by the speedy action of financial authorities.

But when one probes the actions of official regulators a rather different picture emerges.

They are clearly concerned, if not fearful, that the much vaunted “resilience” of the banking and financial system could be undermined and are working to impose measures to prevent such an occurrence.

Under conditions where the $26.5 trillion US Treasury market, the basis of the US and global financial system, has recently had “near death” experiences, the most significant of which was in March 2020, the Securities and Exchange Commission (SEC), under the chairmanship of Gary Gensler, is seeking to put in place regulations that control, at least to some extent, the activities of market participants.

In the wake of the failure of three middle-sized but nonetheless significant American banks a year ago as a result of interest rate rises and the continuing problems of the New York Community Bank, the Federal Reserve, along with other authorities, is trying to establish regulations requiring banks to hold more capital reserves to offset risks posed by loans and other obligations.

These measures are being strenuously opposed by all sections of finance capital as being unnecessary and even dangerous restrictions on their ability to make profit.

We do not know yet what will be the outcome of this conflict, but two things can be said at the outset.

First, because of lobbying and high-powered legal challenges funded by the financial oligarchy, the proposals will be watered down. Fed chair Jerome Powell has already said that measures aimed at making banks hold more capital could be reworked.

Second, whatever regulations are put in place will not eliminate the risk of a crisis and may even increase it. This has been the experience with the Dodd-Frank Act introduced in response to the 2008 crisis which is being blamed for creating liquidity problems in the Treasury market because of some of the restrictions it has introduced.

The thrust of the new rules drawn up by Gensler and the SEC is that more trades in the Treasury market will have to go through a clearing house. Clearing houses stand between a buyer and a seller. They take collateral from both parties, cash from the buyer and securities from the seller. The aim of this measure is to overcome the situation where if a trade between two parties falls through, the losses will not be as large.

The new rule for securities is set to come in from December 2025 when purchases or sales of Treasuries carried by broker-dealers or interdealer brokers must go through a clearing house.

The mechanism will be extended in June 2026 to the so-called repo or repurchase market where cash is raised on a short-term basis, sometimes overnight, by financial institutions using their Treasuries as collateral.

The measure has been introduced because of recent instability in the repo market. The most notable event was in September 2019, when interest rates, which are generally a fraction of a percentage point, went to as high as 10 percent leading to an intervention by the Fed to stabilise the market.

The need for a clearing house mechanism in the Treasury market was outlined in a White Paper prepared by the Treasury Market Practices Group, comprising market professionals and sponsored by the New York Federal Reserve.

It said the structure of the Treasury market had undergone significant changes in the past two decades, particularly as the increased use of advanced technology and automated systems had speeded up the pace of transactions. Market participants “lacked a common understanding of these structural changes” and more rapid trade execution may present risks to a successful clearing and settlement.

Then in something of an understatement it said given its systemic importance, “any significant disruption in the Treasury market would likely impact financial stability.”

In an interview with the *Financial Times* (FT), Gensler made clear he regarded the changes as necessary to maintain the supremacy of the dollar as the global currency. This is vital for US imperialism both in its capacity to run up debt and its ability to impose sanctions on other countries that cross its path. Dollar supremacy has been somewhat shaken in the recent period because of the crises within the US financial system.

“The US Treasury market is… a really important feature in promoting the dollar’s continued leadership around the globe,” he told the FT, adding that “having that reliable, safe and readily accessible and tradeable asset is critical” as it had been for the British and the Dutch when they were major powers in the financial system.

The objections from the representatives of finance capital have come thick and fast and there is a slew of legal challenges in train. As is to be expected, most of them are based on the assertion the regulations will affect profitability and trading as well as liquidity.

But amid all the self-serving claims, there is one that has some validity.

Echoing objections raised by some financial firms, the FT noted: “While introducing a central counterparty to guarantee trading brings a lot of benefits, including efficiency and reliability, it also introduces a huge single point of potential failure.”

In other words, because the financial system is in private hands, subject to the anarchy of the market, changes to deal with one problem do not eliminate crises but merely transfer the risk from one area to another.

The battle against moves to have banks increase their capital in order to offset risks is also subject to ferocious opposition. In an article on the first anniversary of the March banking crisis, the *New York Times* (NYT) reported that banks say the new rules are punishing them.

“They have poured in comment letters to regulators arguing that they helped stabilise the system last year, and that the cost of the proposed rules may ultimately stymie their lending or drive that business to less regulated nonbank lenders.”

Once again, there is an element of truth amid the self-serving objections, namely that tighter regulations in one area will promote a shift to the riskier so-called shadow banking system.

At the time of the three bank failures a year ago—Silicon Valley Bank, followed by Signature and First Republic—there were strenuous efforts to deny its significance. Claims were made that it only affected regional banks that were “outliers,” amid assurances from Fed chair Powell and treasury secretary Janet Yellen that the banking system was “sound and resilient.”

But as the NYT article raised, the prospect at the time was “the threat of a billowing crisis that could threaten the banking industry” in the worst crisis since 2008 which required that the banks and regulators “put together a huge bailout fund.”

The crisis that erupted last March was contained but the conditions that produced it have not gone away.

“Many banks,” the NYT reported, “have been setting aside billions of dollars to cover anticipated losses to owners of commercial buildings.”

The value of those buildings has plunged because of rising interest rates and the increase of working from home as a result of COVID.

These problems have hit the New York Community Bank, which took over the failed Signature Bank. Following a share market plunge it has been rescued by a $1 billion package organised by an investment firm owned by Steven Mnuchin, the treasury secretary in the Trump administration.

It will not be the last bank to run into serious problems.

In a private conference of clients last month, a recording of which was heard by the NYT, Jamie Dimon, the CEO of JPMorgan, said the Silicon Valley Bank collapse could be repeated.

“If rates go up and there is a major recession you’re going to have exactly the same problem with a different set of banks,” he said.

“I don’t think it’s going to be systemic except for that when there is a run on the bank people get scared. People panic. We’ve seen that happen. We haven’t solved that problem.”