FedFin Daily Briefing

Monday, September 30, 2019

GSEs Get New Capital Buffer

As anticipated (see Client Report **GSE143**) Treasury and FHFA today announced that they have modified the terms of the GSEs' Preferred Stock Purchase Agreements (PSPAs), now allowing each GSE to retain earnings in excess of the $3 billion previously allowed. We will shortly provide clients with an in-depth report on the modifications, which allow Fannie Mae to maintain capital reserves of $25 billion and Freddie Mac to do so up to $20 billion. To compensate Treasury, Treasury's liquidation preferences for its preferred stock in each GSE will increase by the amount of the additional capital reserves until the liquidation preferences increase by $22 billion for Fannie and $17 billion for Freddie.

In addition, Treasury and the GSEs agreed to negotiate an additional amendment to the PSPAs to adopt covenants that are broadly consistent with the administrative-reform recommendations contained in the Treasury GSE reform plan. Treasury said that subsequent changes may be appropriate to facilitate a more complete recapitalization plan. FHFA Director Mark Calabria said the modifications represent an important milestone on the path to reform and committed to continue working with Treasury to advance broader housing reform goals, including limiting the government's role in housing finance, increasing marketplace competition, and focusing on affordable housing and sustainable homeownership.

UN Task Force: Financial Disintermediation Can Advance Sustainable Development

The UN Secretary General's Task Force on Digital Financing of the Sustainable Development Goals (SDGs) has released an interim report finding that fintech can accelerate SDG financing by reducing financial intermediation that does not benefit consumers and empowering consumers to collectively direct financing to sustainable projects. Although included in a UN report with uncertain implications for national policy, the new consensus on targeted intermediation is noteworthy. It echoes broader discussion about the dangers of "financialization" and highlights increasing interest in having central banks, "e-money," or nonbanks (see Client Report **FINTECH24**) redefine banking in favor of direct transmission of deposits into investments.

Specifically, the report finds that fintech can advance the SDGs by increasing individual savings that can be channeled into long-term financing vehicles, reducing remittance costs, enhancing the measurement of risks and returns for impact investors, and discouraging tax evasion. Fintech can also improve the alignment of traditional private financing with the SDGs by enabling improved assessments of SDG-relevant risks and opportunities. The performance of public financing in advancing the SDGs can be improved by fintech allowing better tracking of its impact.

However, the report also warns that fintech could deepen the digital divide by failing to enhance the digital infrastructure necessary to expand financial inclusion, particularly in developing countries. The divide could also be deepened through potential algorithmic biases. Although the report says that digital currencies may lower the cost of cross-border payments, it warns that they could also limit sovereign abilities to manage their monetary and economic affairs. The report also notes unresolved data privacy and illicit finance issues, recommending robust regulatory capacity to ensure that big tech companies are using personal data and algorithms in a transparent way and markets do not become overly concentrated. It calls for international cooperation to address cross-border data movements and establish innovative governance mechanisms.

Although it does not address Libra directly, the report suggests that similar governance arrangements that include a coalition of commercial and public interest partners could be designed transparently and inclusively when complemented by traditional regulatory oversight. It also suggests that large-scale digital infrastructure and data management could be conceived as requiring governance akin to that of public utilities. The Task Force will continue to invite analyses and proposals for recommendations. Its final report is expected in the first half of 2020.

New GOP Effort Begins to Quell CECL

Continuing his pushback against CECL adoption (see Client Report **ALLL4**), Rep. Luetkemeyer (R-MO) has introduced legislation to require the SEC to issue a rule applying the Administrative Procedure Act (APA) to the adoption of accounting principles. The APA does not currently apply because the standard setting body, FASB, is an independent private-sector organization. The bill, which goes beyond CECL, would subject the adoption of accounting principles to the APA regardless of the entity charged with setting standards, requiring FASB to seek comment via the *Federal Register* on accounting changes. This would then allow Congressional scrutiny under the Congressional Review Act, effectively giving Congress veto power not only over CECL, but also over any controversial accounting standards such as the mark-to-market rules against which financial institutions fought a losing battle several years ago. The legislation would also require FASB to report on the impacts of CECL adoption on the U.S. economy, market stability, and the availability of credit. Rep. Luetkemeyer said his legislation does not take away FASB's independence but instead forces it to perform the due diligence they have proven "unwilling" to do.

Legislation introduced earlier this year in both the House (H.R. 3182), where Rep. Luetkemeyer is an original cosponsor, and Senate (S. 1564) would require a similar study, but neither bill has seen action since introduction. Although the Senate bill is supported only by Republicans, the House version was introduced on a bipartisan basis with Reps. Gonzalez (D-TX), Sherman (D-CA), Scott (D-GA), Gottheimer (D-NJ), and Cuellar (D-TX) as original cosponsors. Reps. Beatty (D-OH), Wexton (D-VA), Horn (D-OK), Correa (D-CA), Jackson Lee (D-TX), Brindisi (D-NY), and Pappas (D-NH) have also signed on to cosponsor; the bill currently has 49 cosponsors but has nonetheless been stalled by HFSC Chairwoman Waters' (D-CA) reluctance to advance CECL restrictions.

Warren Renews Democratic Attack on Credit Ratings

Following a demand from Sen. Sanders (I-VT) to create a federal registry for consumer reports, Sen. Warren (D-MA) has renewed Democratic attacks on the credit rating agencies that in earlier years led to calls for a federal utility in this sector. In a letter to SEC Chairman Clayton, Sen. Warren accused the credit rating industry of inflating bond ratings because of conflicts of interest in the issuer-pays business model. She thus demanded that the SEC take immediate action to ensure rating-agency legal liability and advance alternative business models. She also renews calls from a recent HFSC hearing (see Client Report **SYSTEMIC87**) arguing that CLOs require risk retention.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing requests@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about GSE Activity Reports, click: http://www.fedfin.com/index.php?option=com_content&view=article&id=18&Itemid=18

- **GSE-093019:** As anticipated, FHFA and Treasury announced the quarter-end agreement allowing Fannie and Freddie to raise capital reserves to $25 billion and $20 billion respectively

- **GSE-092619:** In its latest white paper, FHFA's OIG analyzed CECL's impact on Fannie, Freddie, and the FHLBs.

- **DERIVATIVES35:** Reflecting strong industry pressure and growing concerns about market structure, the banking agencies have joined others with which they share jurisdiction to propose a significant revision reducing the capital cost of the 2015 margin rule for non-cleared derivatives.

- **PAYMENT18:** This report assesses the Senate Banking hearing on the Fed's proposal to own and operate FedNow to speed U.S. adoption of faster payments (see FSM Report **PAYMENT17**).

- **SYSTEMIC87:** Although the HFSC Subcommittee on Consumer Protection and Financial Institutions hearing was convened to discuss draft bills, including one to overhaul the nonbank SIFI designation process, these were not substantively discussed.

- **INVESTOR13:** For the first time since 2007, all five SEC Commissioners appeared before HFSC.

- **FINTECH27:** The CFPB has finalized new policies that lay out when companies are likely to receive no-action letters (NALs) that smooth the path for new product offerings and/or authorize "sandboxes" to ensure that such ventures are fully compliant with CFPB expectations under consumer-protection law and rule.

- **GSE-092319:** In recent years, the GSEs and most importantly the Home Loan Banks have used fed-funds market access to become major overnight lenders to U.S. and foreign banks, essentially replacing large banks in the interbank lending market. In this analysis, we describe this activity, note its role in recent repo-market turmoil, and assess what the Fed might now want FHFA to do about it.

- **REPO5:** As promised, this report assesses the prospects for federal action in the wake of ongoing repo-market turmoil.

- **DERIVATIVES34:** As expected, the FDIC Board voted 3-1 to approve a controversial proposal to eliminate inter-affiliate initial margin requirements for uncleared swaps.

- **INSURANCE60:** Continuing work outlined in an advance notice of proposed rulemaking (ANPR), the FRB has proposed risk-based standards for depository institution holding companies (DIHCs) significantly engaged in insurance.