FedFin Daily Briefing

Thursday, September 17, 2020

Pressure Grows for Substantive LR Redesign

The ECB today joined U.S. regulators (see FSM Report **LEVERAGE23**) in providing temporary leverage-ratio relief for central-bank deposits. In its most recent revisions to the global leverage denominator (see FSM Report **LEVERAGE15**), Basel allowed national regulators to do so under emergency circumstances, meaning that the U.S. and ECB actions do not fall outside Basel's perimeter. However, we continue to expect this perimeter to be reviewed after COVID in concert with an array of other rules that proved problematic under stress. U.S. statutory action in this arena for custody banks (see FSM Report **LEVERAGE18**) also gives Basel as well as other nations grounds for permanent change as desired for central-bank deposits. U.S. temporary relief also for Treasury obligations will prove more problematic due to ongoing fears about undue exposure at many large banks to sovereign obligations that, while given zero risk weights, are higher risk (see FSM Report **CAPITAL220**).

Fed: CCAR Resubmissions to use 2Q Data

Although GSIBs still await the Fed's publication of the global market shock and largest-counterparty default scenarios on which their CCAR resubmissions depend, the *Federal Register* today indicates resubmissions will be based on second-quarter data, including the global market shock and largest-counterparty scenarios. Covered banks are required to submit all necessary data within 45 days of scenario publication, with submissions accompanied by a CFO or an equivalent senior-officer attestation. Comments are due November 16.

Municipal-Finance Facility Faces Challenge

As in its hearing on the Main Street program, today's CARES Act Congressional Oversight Commission hearing on the Municipal Liquidity Facility (MLF) showed sharp differences between Democrats and Republicans. These will surface again when or if Congress renews COVID-relief legislation because Democrats will then try to use the MLF as a low-cost funding vehicle to deliver fiscal policy and Republicans may resist this not only on broad spending grounds, but also concerns voiced today.

Sen. Toomey (R-PA) argued that municipal-bond market liquidity has been restored and the MLF should thus be wound down since it was not meant to replace private capital markets, bail out state or local governments, or substitute for fiscal policy. In stark contrast, Democrats argued that the facility has not done enough, citing the miniscule amounts drawn down so far and what they described as punitive and restrictive terms. Rep. Shalala (D-FL) noted that even localities that went into the pandemic with a surplus now face budget shortfalls. Democratic Commissioner Ramamurti again called on Congress to provide direct aid, but did not suggest the MLF should be abandoned as he did with the Main Street program, pushing also for MLF interest rates at least as favorable as those offered to corporations through the Fed's emergency facilities.

FRB Division of Financial Stability Deputy Associate Director Kent Hiteshew pushed back on the notion of beginning to wind down the facility, saying its $500 billion capacity was not meant to be spent all at once but rather to indicate the Fed's willingness to backstop private capital. Noting that several major issuers are currently contemplating the program, the Fed believes that it should remain open through the end of the year. When asked if it should be extended, Mr. Hiteshew said that was a matter for Congress to determine.

Fed Takes Stress Hammer to Large U.S. Banks

In addition to specifying the stress-test data components noted earlier today, the Fed late this afternoon released scenarios for revised stress tests. In June, it allowed dividending, but noted that it would advise banks on September 30 if these may continue in the fourth quarter. The latest notice reiterates this, setting the FRB up for significant criticism from Democrats if it decides to do so. However, reflecting criticisms of the earlier round, results of the new tests for 2021 distributions name names. The new scenarios are also considerably more stringent than the U, V, or W options on which banks were previously judged.

The first scenarios against which banks will be judged by year-end for future distribution is a severely-adverse hypothetical recession scenario with an unemployment rate of 12.5 percent at the end of 2021, GDP declines of three percent from 3Q/20 to year-end 2021, and a sharp global downturn. The second, "alternative severe" scenario has a peak unemployment rate of eleven percent at the end of 2020 that declines only to nine percent by the end of the scenario. GDP declines about 2.5 percent from the third to fourth quarters in 2020, with each of these scenarios considerably more severe than most forecast yesterday in the FOMC's dot plots. The Board notes its intention to go well beyond baseline assumptions in this round.

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-091720**: As anticipated, today's marathon HFSC hearing with FHFA Director Calabria covered a wide-range of issues we will shortly analyze in detail due to the policy and strategic importance of several exchanges.

- **FAIRLEND8**: HUD has largely finalized a controversial fair-housing rule as proposed, with the new standards for adjudicating fair-housing disputes giving defendants numerous additional protections.

- **GSE-091020**: As we noted yesterday in our in-depth analysis, a CFTC subcommittee has issued a landmark report laying out an array of climate-change risks it urges policy-makers to prioritize to prevent systemic and sector risks.

- **COVID14**: Today's Senate Banking hearing on the status of emergency Fed facilities showed even more clearly the dividing lines between Democrats and Republicans on changes to the Main Street Lending program than the CARES Act Congressional Oversight Commission's recent hearing.

- **GREEN4**: In this report, we analyze an influential and possibly even game-changing paper released today by the CFTC's Climate-Related Market Risk Subcommittee.

- **GSE-090320**: As noted in our three summaries of key FHFA comment letters, FHFA was not exactly overwhelmed by heartfelt praise for its GSE capital rule.

- **COVID13.pdf**: As anticipated, today's House Select Subcommittee on the Coronavirus Crisis hearing with Treasury Secretary Mnuchin reflected contentious negotiations over a phase four rescue package.

- **GSE-090120:** In this analysis, we continue our assessment of comment letters to FHFA on the capital proposal.

- **GSE-083120a**: In this report, we begin our assessment of the comment letters on FHFA's capital proposal that we believe carry the most weight in terms both of FHFA's final rule and what Congress may care to do about it.

- **GSE-083120:** A new Fed staff study finds wide disparities among the mortgage rates borrowers pay on exactly the same loan that has nothing to do with risk and apparently everything to do with borrower sophistication.

- **MORTGAGE118:** Despite its pending proposal to overhaul the entire definition of loans eligible for qualified-mortgage (QM) status, the CFPB proposes also to establish an additional class of first-lien, fixed-rate mortgages that are QMs or given a rebuttable presumption of QM status.

- **GSE-082520:** The CFPB's proposal to allow QM treatment for certain seasoned mortgages will rewrite a decade's worth of securitized lending if macroeconomic and interest-rate conditions turn favorable.

- **GSE-082020:** A new study from FDIC staff challenges the predictive models on which much mortgage underwriting increasingly depends, discrediting both workhorse predictive models used across the spectrum of consumer credit as well as the ML-based mortgage models that fare still worse as macroeconomic, policy, and borrower conditions change.

- **GSE-081920:** Weighing into the GSE-evolution question with its formidable analytical might, CBO today assesses a likely administrative solution in which the GSEs retain all of their earnings for a limited period of time following which common stock goes again on offer to the public and Fannie and Freddie go back to being Fannie and Freddie more or less as they were pre-2008.

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- **OPSRISK21:** Although the Basel Committee believes that its post-crisis capital and liquidity framework significantly enhanced bank resilience evident in a robust industry response to the pandemic, this crisis and other developments are said to highlight the need for additional regulatory and supervisory work to improve operational resilience.

- **GSE-081720:** With the release late Friday of Chairman Crapo's letter to FHFA, the GSEs' refi fee announcement has taken fire from a high-impact Senate Republican along with Ranking Member Brown and HFSC Democrats.

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