FedFin Daily Briefing

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FDIC Staff Hint at Post-COVID Liquidity, Resolution Rewrites

The FDIC's Systemic Resolution Advisory Committee meeting late last week provided new insight into how the FDIC would resolve large banks or nonbank SIFIs, providing unusual transparency into how single-point-of entry (SPOE) resolutions might be conducted and the extent to which the FDIC could handle a nonbank outside the reach of bank buffers and resolution plans. The discussion from several former policy-makers with considerable influence also suggests that a substantive realignment of liquidity and resolution rules is possible as post-COVID regulatory reforms take shape early next year.

Notably, FDIC staff made clear that uncertainty regarding the extent to which ring-fencing would be demanded by home authorities remains a resolution risk for foreign banks doing business in the U.S. and, with regard to host governments, for U.S. banks doing business abroad. However, the FDIC is working to mitigate many of these concerns, noting in particular outreach to foreign regulators to educate them on U.S. bankruptcy proceedings and outreach to domestic bankruptcy judges. The FDIC remains concerned that foreign courts may not understand U.S. law. FDIC staff are also confident that OLA will allow firms to be wound down if bankruptcy is not a viable option, highlighting improvements such as TLAC, additional clarity on SPOE, and improved resolution planning. While no deficiencies were identified in U.S. GSIBs' 2019 resolution plans, the ability of certain firms to implement these in a timely way under stress remains a concern. Former FRB Vice Chair Donald Kohn questioned whether the ability of GSIBs to deploy liquidity in a crisis is constrained by the need to hold enough for resolution, an issue that gained renewed prominence at the start of the COVID crisis. He asked if a less binding liquidity requirement might still continue to ensure the integrity of the resolution system. Former FDIC Chair Sheila Bair pressed for greater clarity around when liquidity buffers should be deployed. Former FRB Chair Bernanke asked about linkages between liquidity positions and stress testing, noting that liquidity is likely sufficient in a single-firm scenario but perhaps insufficient were multiple firms to require resolution. Staff stressed their desire to avoid having to resolve multiple firms at once, but indicated that statute does not prevent multiple firm resolutions – multi-firm planning is possible, but work so far is limited to single-firm scenarios.

Staff also noted that they continue to track the migration of risk to nonbanks, saying that nonbank SIFIs can be resolved via SPOE if necessary but highlighting that not all of the tools available to resolve large banks are available for nonbanks; the FDIC is nonetheless working to craft these.

FRB-NY: Continuing Large-Bank Dividends May Hinder Resilience, Recovery

Taking on recent assertions from FRB-Minneapolis President Kashkari that large banks remain significantly under-capitalized, the FRB-NY's *Liberty Street Economics* blog today assessed large-bank resilience to hypothetical economic recession-and-recovery scenarios. These differ from the Fed's most recent stress test, offering a darker view of capitalization if dividends continue but doing so for a large group of BHCs and under different scenarios, thus complicating comparisons. The analysis found that the 200 largest U.S. BHCs would face an aggregate capital gap (defined as the difference between actual CET1 levels and the amount of CET1 needed to equal the capital minimums plus buffer threshold) of no more than 1.3 percent of the CET1 buffer in a V-shaped scenario even if dividends continued; the gap is only 0.2 percent without continued dividends. However, an L-Shaped scenario results in a capital gap of 16 percent if dividends are halted and jumps to 34 percent if dividends continue. While no banks fall below capital minimums, more than one-quarter of the largest BHCs fall into their capital buffers if dividends continue in an L-shaped scenario. The industry average CET1 ratio would also fall to eight percent. Projected CET1 ratios are 150bps higher at the end of both the L- and V-shaped scenarios when banks suspend dividends, leading the post, like Gov. Brainard in her dissent, to conclude that large banks have more resilience and can better support economic growth if dividends are halted.

CFPB Opens Window for Early Consent-Order Termination

Opening a new avenue for enforcement relief, the CFPB today laid out how it will consider early consent-order termination applications. Opening this option to many entities, early termination will be granted if the CFPB determines that the entity subject to a consent order meets certain eligibility criteria, has complied with the terms and conditions of the order, and maintains a "satisfactory" compliance position in the product or compliance area for which the consent order was issued. Early termination may not be sought within the first year of a consent order or until at least six months after all mandatory redressed is implemented. This option is also available only to entities – not individuals – and is not an option for consent orders imposing a ban on participation in a certain industry, when the order involves violations of an earlier order, or when criminal actions are involved.

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

- **CAPITAL226**: In conjunction with numerous changes to its supervisory stress test (CCAR) for the largest U.S. banking organizations in response to COVID, the Federal Reserve is seeking comment on structural changes to current capital-planning requirements.
- **GSE-100120**: A troubling new IMF staff paper looks at U.S. housing policy since COVID to uncover some worrisome aggregate and distributional effects.
- **CRYPTO15**: Continuing Acting Comptroller Brooks' efforts to enhance innovation at national banks and federal savings associations, the agency has now authorized these institutions to hold reserves associated with certain stablecoin offerings.

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- **GSE-092820**: Following its morning meeting, FSOC late Friday released the staff statement expressing its near-term decision on systemic risk in the secondary mortgage market.

- **AML132**: FinCEN is beginning a process that, while apparently not revising or eliminating any existing anti-money laundering (AML) requirements, would add an over-arching principle that AML programs be efficient, "reasonably-designed," and capable of providing high-quality information to law enforcement and other government entities.

- **COVID15**: HFSC's second CARES Act-required hearing with Treasury Secretary Mnuchin and FRB Chair Powell continued to stress the theme that has become apparent ever since negotiations on a Phase IV relief bill stalled: Democrats primarily want additional direct fiscal support and Republicans are pushing for adjustments to existing relief programs funded by unused 13(3) Treasury backstops.

- **GSE-092220**: As usual, FHFA's new strategic plan is more rhetorical than real. Still, it has a noteworthy emphasis on ending the conservatorship, promulgating new standards, and enhancing inclusion not just at the GSEs and within FHFA, but also in credit access.

- **CRA29**: Emphasizing its new focus on racial equity ahead of several Congressional hearings this week, the Federal Reserve Board today unanimously approved a long-awaited ANPR revising its CRA regulations.

- **GSE-092120**: Late last week, the Federal Reserve Bank of New York announced that the Fed bought almost $56 billion in agency MBS over the past two weeks.

- **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.

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- **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.

- **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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