



# *FedFin Daily Briefing*

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Friday, October 23, 2020

## **Fed Treasury-Market Analysis Targets Mutual Funds, Leveraged Hedge Funds**

As previously [noted](#), Vice Chairman Quarles has prioritized review of the U.S. Treasury market's structure as among his top post-crisis priorities. A [speech today](#) from the head of Fed open-market operations, Lorie Logan, confirmed an extraordinary volume of Treasury sales at the height of the March crisis and high-priority Fed research assessing next steps. Ms. Logan shows that Treasury sales in mid-March came from a wide variety of investors, but mutual funds sold an exceptionally large volume to handle redemption risk. Foreign official accounts also were major sellers, as were highly-leveraged hedge funds – another top Quarles concern. Noting that some [research](#) discounts the role of levered funds, Ms. Logan said that data make this hard to judge but these funds were likely also a major contributing factor to market stress.

Despite this stress, intermediation remains sufficient even in less-liquid market segments. Research suggests that ongoing Treasury issuance increases may stress intermediation capacity, leading the Fed to consider an array of ways to enhance market stability. Ms. Logan did not, however, outline which policies are currently under consideration.

## **Central Bank Calls for NBFI Regulation Intensify**

Joining many other central bankers, Bank of Italy Governor Ignazio Visco [today](#) argued that progress must be made to reinforce the NBFI macroprudential framework, especially for investment funds and insurers. Although macroprudential stress testing may be a useful tool for assessing shock propagation across the financial system, this remains at a preliminary stage. Policymakers should thus consider several requirements for NBFIs including minimum liquidity buffers, rules to reduce structural liquidity transformation, and additional requirements for synthetic and traditional leverage. Concentration and interconnectedness should also be investigated.

With regard to banks, Gov. Visco warns that the scale of the COVID crisis could require “extraordinary” intervention. He specifically notes the need to manage non-performing loans and highlights proposals to deploy special purpose vehicles that allow private investors to contribute capital to bank NPL management effort.

## **IMF Cites Growing Financial-Stability Risk**

Renewing its call for a short-term ban on bank capital distribution, the IMF's [Global Financial Stability Report](#) lays out the Fund's fears that corporate liquidity pressures, especially at SMEs, may turn into solvency stress. Sovereign risk is also a growing concern. Although most banks are robust, weaker banks have a capital shortage of approximately \$220 billion, which the Fund says could lead to significant structural vulnerabilities without a swift recovery and/or fiscal support. Although banks should be allowed to continue to use their capital buffers, these should be rebuilt as quickly as possible and debt forbearance should end as soon as feasible in the absence of solvency support. The Fund continues to press for policies that support green investment, digitalization, and inclusion and joins the FSB in prioritizing NBFi reform after the crisis, going on also to target the need for prudential safeguards given prolonged ultra-low interest rates.

## Sharp Decrease in Cross-Border Transaction Reporting Threshold Proposed

Taking a tough stand on transaction structuring and cryptocurrency, the FRB and FinCEN [today](#) proposed to lower the international-transaction data and reporting threshold from \$3,000 to \$250. This very significant change is based on the agencies' view that smaller-value cross-border transaction information is useful in criminal, tax, and regulatory proceedings as well as in intelligence activities regarding international terrorism. The FRB says that benefits to national security and law enforcement outweigh the negative effect on institution costs or payment-system efficiency, with both agencies also noting that many transmittals related to terrorist financing, drug trafficking, and other crimes now occur well below the current threshold. No change to the domestic threshold is proposed.

The proposal would also clarify that the meaning of "money" as it relates to both the domestic and cross-border thresholds includes convertible virtual currency that constitutes a medium of exchange such as cryptocurrency. Comment on these significant changes is due thirty days after *Federal Register* publication, suggesting fast action on a final rule.

## Democrats to Demand Bank Fossil-Fuel Divestiture

Signaling Democratic plans to force fossil-fuel divestiture in the next Congress, Senator Merkley (D-OR) has introduced two bills banning banking-organization holding in this sector and forcing the U.S. to oppose it at international financial institutions. [S. 4835](#), the Protecting America's Economy from the Carbon Bubble Act, amends the BHC Act to prohibit an array of regulated banking organizations from facilitating fossil fuel production from new sources via investment, loans, derivatives, fees, or international trade financing. Violators would be banned from future employment with any BHC or publicly-traded corporation. We will shortly provide clients with an in-depth analysis of the measure which, while we expect it to be pressed next year, faces high odds of enactment even in a "triple-blue" scenario.

[S. 4834](#), the Sustainable International Financial Institutions Act, would require U.S. representatives to International Financial Institutions to vote and advocate for reducing carbon emissions and transitioning to a clean energy economy. They would also be required to oppose loans or assistance that would create new capacity for fossil fuel activity. Treasury would be directed to reduce contributions to International Financial Institutions matching those the institution contributes to fossil fuel activity.

## Recent Files Available for Downloading

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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](http://www.fedfin.com) or clients may obtain the reports/analyses by e-mailing [requests@fedfin.com](mailto: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](http://www.fedfin.com/index.php?option=com_content&view=article&id=18&Itemid=18)

- [GSE-102120](#): As we noted late last week, African-Americans and Hispanics have a heck of a time enjoying the benefit of low mortgage rates despite like-kind default risk to white borrowers.

- **[PAYMENT21](#)**: The FSB and many other global bodies have finalized a vision of cross-border payments with far-reaching implications not only for payments, but also for personal privacy, regulatory arbitrage, the role of nonbanks, cross-border resolution, monetary-policy transmission, and financial stability.
- **[GSE-101520](#)**: Although direct mortgage discrimination based on race and ethnicity has abated in recent years, a new [study](#) from the Federal Reserve Bank of Boston shows a striking difference in prepayment rates due to refinancing-speed differences directly attributable to race and ethnicity after controlling for an array of well-accepted underwriting risks.
- **[CRA30](#)**: Following opposition to the OCC's CRA rewrite, the FRB has proposed an initial construct that takes some elements of the OCC's approach and adds further and in some cases different provisions to craft what the Fed hopes will become an inter-agency CRA construct in 2021.
- **[BIGTECH](#)**: Last week, the House Judiciary Antitrust Subcommittee released a lengthy, high-impact Democratic [report](#) calling for structural changes to the nation's biggest tech-platform companies.
- **[GSE-100820](#)**: As will soon be detailed in our in-depth report, the Federal Reserve's long-awaited [CRA proposal](#) is a comprehensive rewrite that, while preliminary, would dramatically change large bank community-focused lending and investing.
- **[CORPGOV31](#)**: In this report, we analyze the strategic implications of enforcement actions against Citibank issued late yesterday by the [Fed](#) and [OCC](#).
- **[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.
- **[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.