FedFin Daily Briefing

Monday, November 2, 2020

Eschewing Guidance, Agencies Issue Operational-Resilience Paper, Best Practices

In a highly unusual move, the federal banking agencies late Friday released a paper on sound practices to help large banks increase operational resilience, amalgamating practices from across the agencies into one comprehensive document. It is drawn from existing regulations, guidance, and statements and thus does not create new obligations; however, the paper also includes what the agencies describe as common industry standards and best practices usually expressed in supervisory communications, not a "paper." The agencies likely did not issue the paper as official guidance due to their outstanding NPR codifying a 2018 interagency statement that supervisory guidance is not binding and cannot be the basis of an enforcement action. However, examiners are sure to look to this paper when assessing large-bank operational resilience.

The paper highlights that sound operational resilience is grounded in effective governance. Robust operational risk and business continuity management are essential and should be informed by rigorous scenario analyses and consideration of third-party risks. Secure and resilient information systems are also necessary. The paper also lays out practices specific to managing cyber risk, covering guidance and industry standards on governance, identification, protection, detection, response, recovery, and third-party risk management. The agencies will in coming months convene public discussions on how to further operational resilience and may update the sound practices highlighted in the paper if warranted. Discussions will focus in particular on ways in which large and complex firms can improve operational resilience of critical operations and core business lines at material entities and how to measure operational resilience and achieve it.

Much in the paper echoes recent global efforts sparked by the pandemic, growing climate risk, and recent operational incidents. The Basel Committee recently issued a consultation as well as principles on operational resilience (see FSM Report **OPSRISK21**) but has not indicated any action timeline. The U.S. approach outlined above is largely consistent with this Basel framework even though the U.S. has yet to finalize Basel's 2017 revisions to the operational risk-based capital construct (see FSM Report **OPSRISK20**).

OCC Offers a QFC Out

Resolving an outstanding issue from the 2017 rule addressing the complex challenge of qualified financial contracts in a systemic resolution (see FSM Report **QFC6**), the OCC today made public an order issued on September 30 granting an exemption to the QFC stay rule for certain non-linked, non-U.S. derivatives contracts. The QFC-stay rule requires that most QFCs to which U.S. GSIBs are a party expressly recognize FDIC stay or transfer orders in the event of a resolution. This issue remains a vexing one in the absence of revisions to the U.S. Bankruptcy Code expressly bringing QFCs under an FDIC resolution under the terms of Dodd-Frank's orderly liquidation authority (see FSM Report **SYSTEMIC30**). Congress has wrestled with this problem ever since it came to light, but has never been able to agree on Code revisions. If there is a Biden Administration and it proceeds on the bankruptcy reforms promised by the Vice President, we expect the QFC provision to be addressed in concert with broader changes ending the protections afforded to derivatives in the 2005 Code rewrite.

Under this order, exempted derivatives are those between a GSIB's foreign subsidiary and other foreign subsidiaries that are not guaranteed or otherwise supported by an affiliate of the foreign subsidiary (e.g., the parent bank) subject to U.S. systemic-resolution proceedings. The contract must also not be linked to an affiliate of the subsidiary and contain no default rights that could be exercised against banking organizations subject to U.S. systemic resolution. The OCC's rule will have the greatest impact on GSIB derivatives activities since much of it is conducted in national bank entities. The FRB has not made public any like-kind order, perhaps unwilling to do so in light of the concerns expressed in the QFC-stay rule about runs on subsidiary derivatives creating liquidity or even solvency pressure on parent banks.

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-110220**: Here, we follow our in-depth analysis of the OCC's new true-lender rule with an assessment of the standards' mortgage-market consequences.
- **PREEMPT35**: In the wake of its final rule on the "valid-when-made" doctrine, the OCC has moved quickly to finalize its controversial proposal defining when a national bank or federal savings association (FSA) is a "true lender" for purposes of state usury ceilings and consumer protection.
- **FAIRLEND9**: Congressional Democrats have introduced legislation that formally expands civil-rights obligations to financial institutions.
- **GSE-102820:** This analysis builds on our in-depth assessment of the new inter-agency net stable funding ratio (NSFR) rule to highlight strategic implications for U.S. housing finance.
- **LIQUIDITY32:** After expectations that the U.S. might well not adhere to the Basel Committee's NSFR standards, the banking agencies have finalized their 2016 proposal, albeit in significantly revised form.
- **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.

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- **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 an 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.

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- **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.

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