GSE Activity Report

Thursday, January 21, 2021

Getting Greener

Summary

As forecast following a landmark CFTC-committee report and the Fed's financial-stability assessment, FHFA has now turned to the climate risk that worries them the most: residential real estate. Reflecting also the priority Yellen's FSOC and the Biden Administration will put on addressing this risk, the agency has now sought views on how much risk there is, how best to measure it, and what then to do about it.

Impact

FHFA's request for input (RFI) is far short of a specific proposal. Indeed, RFIs are an increasingly common device agencies use when they know they have a problem but are still wary of starting the administrative process presaged by a formal advance notice of proposed rulemaking. With an RFI, regulators can gather facts without creating legal or political expectations of forthcoming action.

And, if any RFI preserves all options, it's this one – FHFA asks many far-reaching questions but provides little insight into what it might wish to do. FHFA is seeking views not only on risks to Fannie and Freddie, but also the Home Loan Banks. Many questions – e.g., how even to define this risk – are very basic and all of the RFI's questions are straightforward.

Although the capital rule assumes the need for buffers atop the operational-risk charge for climate risk, the RFI does not address this risk mitigant; instead, it seeks views on alternatives such as insurance and CRT. Indeed, in the only glimmer of an FHFA opinion, several questions suggest that FHFA is keen on risk transfers, not policy changes such as reduced exposure to coastal property. Should FHFA pursue a risk-transfer approach to climate-risk mitigation, it will find itself an outlier from the banking agencies, which have long distrusted both the resilience of third-party insurance and its willingness to pay claims under stress.

The agency also asks if stress testing, scenario analysis, and/or new disclosures would improve its supervision of climate and disaster risk. Reflecting the new focus on racial equity, several questions also probe climate risk's impact on low-income and/or minority borrowers and what might best be done to mitigate it.

As we have previously noted, the Fed and other financial agencies have come around to reckoning with climate risk, but they are still far short of agreeing to anything beyond new disclosures and lots more data-gathering in areas such as scenario analysis. Controversial proposals sure to be pushed by Democrats such as "brown-penalty capital charges" or express restrictions on fossil-fuel exposures

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will be quietly, but fervently, resisted by the Fed, giving FHFA cover to defer many of the specific options on which comment is sought unless or until a new policy framework takes shape or Congress takes action.

Outlook

Comments are due by April 19. Whatever FHFA then does with them will depend at least as much on what FSOC stipulates for member agencies as what these cards and letters urge FHFA specifically to do.

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