FedFin Daily Briefing

Thursday, February 25, 2021

Biden Formalizes End to Trump's Reg-Relief Principles

Among the Trump executive orders repealed by President Biden is one instructing Treasury to examine laws, rules, and other financial-regulatory actions that contravened the Trump Administration's principals on efficiency, reduced burden, investor freedom (i.e., no ESG requirements), and an end to moral hazard. The principles also opposed bailouts, hinting at an effort to repeal Title II of the Dodd-Frank Act – orderly liquidation authority (see FSM Report **SYSTEMIC29**) – that was never initiated. The Trump EO did not lead to specific rule changes, but Treasury did issue a series of reports on policies that would have implemented the principles and the OCC and FDIC took many of them to heart. The EO also encapsulated the regulatory-relief ethos that dominated much regulatory and Congressional action over the past four years. Secretary Yellen strongly opposes an end to the orderly liquidation and much else in the initial Trump guiding principles and the overall Administration approach – especially its focus on racial equity and economic equality – will take financial regulation in a very different direction.

Quarles Defends SCB, Announces Additional Model Transparency/Risk Recalibration

FRB Vice Chairman Quarles today continued his quest to refine stress testing and Fed supervision to suit his vision of a more effective and less burdensome system. Mr. Quarles strongly defended the recent decision following the last tests to permit capital distributions, noting that earlier restrictions may not have been necessary and that the stress capital buffer is no less stringent than CCAR. The U.S. is, he said, advanced in comparison to other nations that either suspended stress testing during COVID or continued to rely on company-run models, not tough, supervisor-set scenarios. Next month, the Fed will provide still more information on its test models, with Mr. Quarles arguing that this transparency enhances public understanding despite concerns that it also allows banks to game the system. The Fed plans also to refine testing to reflect the complexities resulting from significant fiscal stimulus atop the pandemic's macroeconomic chock, with longer-term work planned to refine risks measurement to take account of both bank technology and the growing role of nonbanks. An array of issues banks have raised (e.g., regarding interest-rate hedging) are also under review. Finally, Mr. Quarles renewed his call for more data-driven, transparent supervision.

FSB Accelerates MMF Reform

FSB Chair Quarles today updated G20 finance ministers on the 2021 work program, now detailing delivery dates for previously-announced initiatives. Speeding up original timetables to align better with those in the U.S. (see Client Report **MMF16**), a consultation on MMF resilience considering both the structure of and potential vulnerabilities in underlying short-term funding markets will be released in July. A final report will then be issued in October along with a report on the FSB's overall progress on its NBFI work (see Client Report **NBFI**). The FSB will also report in April on its work to address COVID related vulnerabilities, including work to unwind support measures, avoid cross-border spillovers, and analyze rising corporate debt. It will also in April deliver its final evaluation of bank TBTF reforms and deliver its final set of targets on cross-border payment objectives in October in tandem with an overall progress report on the FSB's roadmap to enhance cross-border payments.

HFSC Members Raise Alarm Over Crypto in Domestic Terrorism Financing

This morning's HFSC hearing on domestic terrorism financing focused on the need to investigate how domestic terrorists fund their activities to reduce their access to the financial system. Members on both sides of the aisle voiced concern over the use of cryptocurrencies by domestic terrorist groups, with Chairman Himes (D-CT) noting that groups are eschewing the traditional banking sector in favor of cryptocurrency. Republicans were also concerned about ensuring privacy and free speech. Following this session, which Chair Waters (D-CA) attended, we expect the full committee to take up several bills to give FinCEN greater powers to combat domestic terrorism financing.

Syndicated Loans Signal Growing Risk Supervisors to Monitor

The banking agencies today issued their annual syndicated-credit report, now finding a doubling of overall troubled loans and still worse performance in hard-hit sectors. However, banks hold only about a quarter of these loans, with the agencies singling out agent banks for risk-management improvements in recent years. They also note significant improvements in U.S. bank regulatory capital and provisioning as effective safeguards. There is no hint of any effort to renew rules or toughen guidance against leveraged lending, with the statement noting only that supervisors will monitor the sector, risk mitigation, and credit enhancement.

FedFin Assessment: Fed Outage Alters Payment-System, CBDC Debate

The Fed's payment-system outage yesterday comes at a more than awkward time for the central bank's efforts to advance FedNow without ensuring inter-operability. As previously noted, the Fed's most recent update on FedNow stated that the system might well be operational in 2023, if not a bit earlier, but inter-operability would not be functional at that time. However, to the extent that bank electing the Fed's instant-payment system cannot easily transfer to the TCH alternative or any other systems that come online, the nation could prove still more dependent on a single point of operational failure. If Fed outages last longer than the few hours of the last few incidents, then systemic risk is possible from the Fed just as the Fed fears it from operational risk at other financial-market utilities.

At the Humphrey-Hawkins hearings earlier this week (see *Client Report* **FEDERALRESEVE60** and **FEDERALRESERVE61**), Chairman Powell heard from Democrats that they want FedNow open as quickly as possible. Many also want a CBDC far more quickly than the Fed now contemplates. It remains to be seen if this "glitch" deters these efforts, but Republicans are warier of central-bank control over still more of the payment system. They will thus use this incident to assert that private systems may be necessary to ensure payment-system stability.

Pressure Grows for Diversity, Climate Disclosures

At today's HFSC Capital Markets subcommittee hearing on climate change and social responsibility, Chairman Sherman (D-CA) led Democrats in pressing for greater climate, diversity, and executive-pay disclosures and for investigations into dark money and tax havens. Democrats will advance these goals first through legislation aimed at mandating climate and executive pay disclosures. Ranking Member Huizenga (R-MI) led Republican pushback, arguing against mandated ESG disclosures on grounds that these deter businesses from going public and add unnecessary burden. Chairwoman Waters (D-CA) joined the hearing in the last few minutes to ask how corporate climate-risk disclosures might help local governments better serve their communities. Hours after Rep. Huizenga called out the SEC for going beyond its mandate into racial justice and climate change, the SEC's acting chair, Allison Herren Lee, said that the she believes the SEC should revisit disclosure requirements on diversity.

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 info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **GSE-022521:** In a new paper, Lew Ranieri, who needs no introduction, and Mike Calhoun of the Center for Responsible Lending float an important new idea along the way to turning the GSEs into the utilities presaged by actions under the Trump Administration to recast the conservatorship.
- **FEDERALRESERVE61:** At today's HFSC hearing, Chairman Powell not only delivered the same testimony, but faced many of the same questions to which he provided the same answers. He would not, for example, commit to ending the SLR exemption (see FSM Report **LEVERAGE23**) or to condition any continuing exemption on capital-distribution restrictions.
- **GSE-022421:** As anticipated in an earlier FedFin report, we confirm that U.S. banking agencies plan to turn quickly to U.S. implementation of the 2017 "Basel IV" package.
- **FEDERALRESERVE60:** As usual, Senate Banking's hearing today with Chairman Powell strayed from monetary policy and post-pandemic prospects to a range of financial-policy critical questions.
- **REALESTATE24:** Continuing the OCC's recent actions to expand national-bank powers into unprecedented arenas, the OCC has now proposed major liberalization of the ways in which federally-chartered organizations may use commercial real estate owned as bank premises.
- **GSE-020121:** While it will take time for the swamped Biden Administration to craft U.S. housing policy, elements of it emerged last week during stimulus negotiations, the President's statement, and HUD-nominee Fudge's appearance before Senate Banking.
- **CAPITAL227:** Although the FRB in its proposal indicated that this rulemaking would also begin consideration of the U.S. large-bank capital framework post-COVID, its final rule largely confines itself to aligning stress-test standards with the 2019 tailoring rule and stress capital buffer (SCB) for Category IV banking organizations.
- **GSE-012221:** The failure of yet another Administration and Congress to conquer the conservatorships does not augur well for constructive policy action anytime soon.
- **INVESTOR14**: In this report, we expand on prior forecasts to assess broad financial-regulatory and structure issues under the SEC's jurisdiction under what seems likely: a Chairman Gensler. His will be an activist SEC, one sure to throw broker-dealers, asset managers, and investment funds from the relative comfort of the last four years.
- **GSE-012121**: 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.

- **GSE-011521:** Last night, Treasury and FHFA announced an agreement on the GSEs' conservatorship unsatisfactory to all concerned and highly objectionable to many of those on the Hill with the power to change it.

- **GSE-011321:** Setting Senate Banking's agenda yesterday, incoming Chairman Brown highlighted refi inequality as a top committee priority.

- **CRYPTO17:** This interpretive letter (IL) follows an OCC advance notice of proposed rulemaking that suggested a notice-and-comment process before the agency made substantive changes to the digital-currency powers of federally-chartered banks.

- **AML133:** In a cliff-hanger before the end of the 116th Congress, the National Defense Authorization Act was enacted into law with an array of provisions significantly revising U.S. anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements.

- **ELECTION25**: It will take considerable time for Congress to absorb the meaning of yesterday's insurrection not only in institutional terms, but also and more immediately with regard to each Member's thinking about his or her own policy and political agenda.

- **TMARKET**: As we noted earlier (see *Client Report* **REFORM200**), we do not expect U.S. regulators to extend SLR relief (see FSM Report **LEVERAGE23**) after its scheduled March expiration.

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