FedFin Daily Briefing

Tuesday, March 23, 2021

BIS: Mutual Funds Need New Buffers

Pressing the case for mutual-fund reform, senior BIS staff have concluded that poor liquidity-risk management – not investor redemptions alone -- led to acute distress as shown by the fact that bond-fund asset sales exceeded redemptions except where funds have pre-existing, effective liquidity-risk management protocols. The BIS paper thus emphasizes that actions to stem investor runs may not suffice, reinforcing conclusions most recently laid out for MMFs by Fed officials favoring fund capital requirements or minimum balances at risk. The Fed has also discussed asset-type restrictions (see Client Report **SYSTEMIC89**) for open-end funds. Funds of all kinds have often countered regulatory demands with arguments that investors understand risk, but the BIS paper counters that traditional "pecking-order" assumptions about runs were not evident in March of 2020. Notably, investor behavior also did not vary by a fund's cash buffers. This finding is not explored in the BIS paper, but may suggest the benefit also of uniform liquidity rules or other transparent standards to create positive incentives for strong cash buffers.

FRB Ramps Up Climate-Risk, Scenario Analytical Capabilities

Continuing her focus on climate change, FRB Gov. Brainard today announced a significant increase in the central bank's analytical and supervisory efforts. As will be detailed shortly in an in-depth analysis of Chairman Powell's HFSC testimony today, the Fed thinks climate risk is well within its safety-and-soundness mandate, strongly rejecting GOP assertions to the contrary at a recent Senate Banking hearing (see Client Report **GREEN7**). Reflecting this, Ms. Brainard announced formation of a Financial Stability Climate Committee with a largely macro focus on matters such as disclosure and systemic-risk exposures. The committee will also identify areas where microprudential actions (e.g., climate-risk hedges) benefit an institution but increase systemic risk. Micro and macroprudential issues also overlap when risks correlate or transfers lead to unanticipated concentrations, making these considerations also a top FRB priority along with global coordination. Nothing is immediately planned in the way of specific forecasts, let alone stress tests, with the Fed instead focusing on developing its capacity to conduct long-term scenario analyses capturing complex interactions between banks and nonbanks and across the financial system.

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.

- **REFORM203:** At today's HFSC hearing on pandemic-relief programs, Members asked also about key financial-policy questions.
- **GSE-032321:** Last week, we analyzed a Federal Reserve study showing that unemployment is still inexorably linked to mortgage-default risk.

- **GSE-032221:** As we predicted, federal banking agencies didn't back down: the SLR exemption for central-bank reserves and Treasuries is no more as of April 1.

- **GREEN7:** Today's Senate Banking Committee hearing on climate risk made it clear that the partisan divide evident earlier this week on housing (see Client Report **MORTGAGE119**) and much else extends to what financial regulators should do about climate risk.

- **GREEN6:** Reflecting views of the Biden Administration and those of its nominee to chair the SEC, Acting Chair Allison Herren Lee is requesting public views ahead of more formal proposals revising the climate-risk disclosures to be required of publicly registered companies.

- **GSE-031721:** As our in-depth report makes clear, the Senate Banking (and Housing!) Committee's hearing yesterday showed the wide partisan chasm between what Democrats and Republicans want of the GSEs.

- **MORTGAGE119:** Reflecting Chairman Brown's (D-OH) prioritization of the "housing" jurisdiction under Senate Banking, the panel's hearing today addressed not only GSE reform, but a sweeping range of rental and affordable-housing considerations in concert with lending discrimination and housing finance.

- **UDAP7:** Continuing the quick reversal of numerous Trump-era policies, the CFPB has ended a controversial policy statement providing consumer-finance companies with considerable protection from assertions of abusive acts or practices.

- **GSE-031621:** A new FEDS Note unpacks the unprecedented patterns of mortgage default risk during the pandemic to find that unemployment will tell the default tale.

- **REFORM202:** At a wide-ranging hearing, HFSC today launched its inquiry into racial equity in the financial system. Democrats offered a sweeping array of solutions, with witnesses alleging discrimination in lending and the failure of the banking system for people of color.

- **GSE-031021:** As previously noted, the CFPB has decided to restore the DTI-based QM along with the patch without withdrawing its price-based QM or the seasoning rule, essentially allowing mortgage lenders to do pretty much anything and sell as much of their volume as Fannie and Freddie will bear.

- **INVESTRO16:** While Senate Banking's GameStop hearing today continued many of the partisan battles fought when HFSC held its first hearing on the matter, at least one area of consensus emerged today: the need to decrease settlement times.

- **REFORM201:** Although today's Senate Banking hearing on Wall Street's role was poorly attended, it nonetheless captures the theme Chairman Brown (D-OH) intends to guide his work this Congressional session: "Wall Street" incentives adversely affect equity, equality, economic growth, and social welfare and thus require structural, sweeping reform.

- **INVESTOR15:** The Senate Banking Committee today took up two of the more contentious nominations so far to come its way: those for Gary Gensler to chair the Securities and Exchange Commission and for Rohit Chopra to head the CFPB.

- **GSE-030221:** Critics of FHFA policy are finding still more affordable-housing ammunition to add to their anti-PSPA armament.

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- **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.

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