FedFin Daily Briefing

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Fed Analytical Framework Buttresses Incremental Climate-risk Action Framework

Buttressing the macroprudential approach to climate risk announced yesterday by FRB Gov. Brainard, a new FEDS Note outlines a cautionary analytical approach to measuring, anticipating, and mitigating systemic climate risk. It does so by deploying the framework established by the Fed's semi-annual financial-stability reports (see *Client Report* **SYSTEMIC89**), constructing a simpler analytical framework than the one in current international use. And, like Gov. Brainard, the paper emphasizes the need also for more research and data transparency before risk-measurement systems are used for binding risk-mitigation and -management standards.

Much in the paper reiterates explanations of the intersection between climate and financial risk established in prior work, but it goes on to incorporate these factors into the Fed's framework for identifying potential sources of financial shock rather than attempting to predict them. New detail builds on discussion in Ms. Brainard's speech about how microprudential risk-mitigation efforts (e.g., insurance, pricing) may nonetheless amplify or concentrate systemic risk. However, the staff note also concludes that lack of established accounting or measurement standards combined with broader climate-risk uncertainties amplifies and correlates systemic risk, with these also detailed in the paper to support its assertions that express risk-mitigation standards could actually exacerbate micro and macro financial-sector risk.

FRB-NY: SLR May Adversely Affect Dealer-Bank Intermediation

The Federal Reserve Bank of New York's blog today tackles the SLR-critical question of why financial markets froze last March, causality that -- if attributable -- will affect the extent to which U.S. regulators decide to revise the SLR denominator and, if they do, get Congress to accept it. Ducking the question yesterday (see *Client Report* **REFORM203**), Chairman Powell said that, while it is important to ensure that the leverage ratio does not again become a binding constraint, the Fed "threw the kitchen sink" at the crisis and thus is unsure how important the SLR might be.

Concluding that dealers maintained portfolios in government and agency paper through the worse of the crisis, the post's authors note that overall dealer-bank balance-sheet reductions were in higher-risk obligations (e.g., corporates, CP). And, even with these reductions, dealers generally maintained intermediation even from late February through late March of 2020. However, market disruption continued despite this intermediation, signaling that – while dealers maintained liquidity – the amount they provided was insufficient even in USG and agency markets due to the extent of nonbank demand. Internal risk-management and regulatory-cost barriers may account for why dealer banks then did not provide still more intermediation, but the paper concludes only that it is important quickly to determine the best way to ensure dealer-bank liquidity sufficient to take on considerable additional risk under acute stress.

Central Banks Told to Take Cautious Steps to Climate-Risk Recognition

Reflecting the caution epitomized in recent Fed comments, the Network for Greening the Financial System (NGFS) today reported on the obstacles confronting incorporation of climate risk into monetary-policy operational frameworks. Despite the raft of options presented by this central-bank/supervisory group, the report suggests that optimal policy requires gradual transition given the large degree of uncertainty of both the timing and magnitude of climate risks. It thus urges near-term work focusing on disclosures.

More ambitious options targeting credit operations include adjusting pricing to reflect counterparty climate-related lending or collateral composition, as well as adjustments to central-bank eligibility. Other options would adjust collateral policies, perhaps by aligning collateral pools with a climate-related objective or introducing negative and/or positive screening. Proposals to adjust asset purchase programs are also evaluated, noting that central banks might skew asset purchases according to climate-related risk criteria. Central banks are also told to consider potential consequences of climate-risk actions on transmission, the degree to which climate change is mitigated, financial-sector risk-mitigation effectiveness, and operational feasibility.

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.

- **REFORM204:** Following yesterday's HFSC session (see Client Report **REFORM203**), Secretary Yellen and Chairman Powell today faced Senate Banking and, as before, a raft of questions with little to do with the hearing's ostensible focus on CARES Act programs.

- **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.

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- **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.

- **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.

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