FedFin Daily Briefing

Thursday, March 25, 2021

ECB: Central Banking is Distributional, but ECB's for the Greater Good

The European Central Bank yesterday released a lengthy bulletin assessing the extent to which monetary policy has an impact on economic inequality. In sharp contrast to the FRB, the ECB's paper readily acknowledges that monetary policy has distributional impact, but it does go on to defend ultra-accommodative ECB policy against inequality assertions. Some of these defenses are germane only in the EU, where most mortgages have adjustable rates and thus benefit immediately and directly from lower rates in sharp contrast to the U.S. Other conclusions are in our view quixotic even within the EU; for example, the paper argues that low rates are beneficial to retirees because they can more readily invest assets in long-term holdings to support consumption, but we think this is true only if the retiree has sufficient non-savings net assets to liquidate to generate significant capital income. Those saving for retirement in the EU would still be as adversely affected as U.S. savers under ultra-low rates, although the distributional impact in the EU might be significantly less due to far greater reliance there on defined benefit plans and larger transfer payments to the elderly.

Even more fundamentally, the EU is considerably less unequal than the U.S. The ECB provides extensive discussion of this comparative point without drawing conclusions from it. The paper does state that inequality has an adverse impact on monetary-policy transmission because lower-wealth households may not respond as anticipated to expansion signals, but it also concludes that monetary policy is likely not a significant cause of economic inequality because most advanced nations have adopted similar policies yet inequality varies widely. However, the paper does not account for structural distributional differences and thus may understate the distributional power of monetary policy in the U.S. and other non-EU nations. The paper's principal recommendation is greater central-bank reliance on heterogeneous data.

Toomey Increases Criticism of SEC Climate, ESG Actions

Continuing his criticism of regulatory climate agendas (see Client Report **GREEN7**), Senate Banking Ranking Member Toomey (R-PA) today sent a letter to SEC Acting Chair Lee asking for more information on the SEC's new ESG task force. He again urged the Acting Chair to resist using enforcement as a "backdoor" to impose new ESG or climate regulation. Disclosure or enforcement actions are, he said, premature as the SEC has yet to complete a review of its 2010 guidance on climate change disclosures (see Client Report **GREEN6**). Further, there is no confirmed SEC chairman. Reminding Acting Chair Lee of the need to provide fair notice and comply with the Administrative Procedure Act, Sen. Toomey also requested a staff briefing no later than the week of April 5.

Climate-Risk Standards for Insurers Take Shape

Again leading the way on key Democratic financial standards, the New York Department of Financial Services (NYDFS) today proposed guidance for insurers on integrating climate-risk into their governance, risk management, and business strategies. Insurers would be expected to assess the significance of climate-related financial risks and take a "proportionate" approach to managing these. This approach should reflect the insurer's exposure as well as the nature, scale, and complexity of its business. However, NYDFS makes clear that this guidance would not constitute its final supervisory approach to managing and disclosing climate risks, noting this will evolve as industry and supervisory practices advance.

Specifically, the proposed guidance tells insurers to integrate climate risks into governance, with boards both understanding and being responsible for managing climate risks. This should be reflected in the company's risk appetite and organization. Insurers should also consider both current and forward-looking climate impact when making strategic and business decisions over the short-, medium-, and long-terms. They are also told to incorporate climate risks into existing financial risk management and risk and solvency assessments. Scenario analysis should be used to inform business strategies and risk assessment/identification, with this considering both physical and transition risks as well as multiple carbon emissions and temperature pathways. Disclosure of climate risks is also expected, and insurers should consider initiatives such as that from the Task Force on Climate-related Financial Disclosures. Comment is due June 23; NYDFS will host a webinar on the proposal April 8.

Big Banks Catch Capital Break

Doubtless reflecting Secretary Yellen's comment yesterday (see *Client Report* **REFORM204**) that she no longer opposes big-bank capital distributions, the FRB today unanimously lifted temporary restrictions on dividends and share repurchases, announcing that these will generally end at the end of the second quarter. As a result, the Fed's stress capital buffer (see FSM Report **CAPITAL225**) will again be the binding constraint for covered banking organizations. However, any bank that falls below its SCB will remain subject to capital-distribution restrictions through the third quarter and, if it still remains unsatisfactory, then will come under still more stringent restrictions. This "give-one" to big banks follows a "take-one" last Friday when the banking agencies decided not to extend SLR exemptions past the end of the second quarter. This was roundly applauded by Democrats during Mr. Powell's testimony this week, likely blunting opposition to renewed dividends and stock buy-backs.

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.

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- **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.

- **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.

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- **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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