Federal Financial Analytics, Inc.

THE GREEN EFFECT

Although often dismissed as a "plan for plans," President Biden's climate-change executive order will redefine U.S. housing finance and, over the next two years, also recraft financial-institution lending and asset-management strategy.

The analytics below are based on in-depth reports provided to FedFin clients.
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In our 2020 issue brief, Federal Financial Analytics forecast that it wasn't just the planet that was warming – U.S. financial institutions were about to come under high-heat demands to realign their strategy on climate change. Indeed, many large banks and asset managers already felt the heat, already signing up for global groups, reallocating asset holdings, retooling internal procurement and operational protocols, and reconsidering their own and their clients' asset allocations. However, doing what a firm thinks right to address climate risk is one thing; doing what is demanded of it to do it differently, faster, or more transparently is quite another. With the new executive order (EO), U.S. financial institutions are themselves under a new order in which their adherence to climate-change reduction protocols puts them behind only fossil-fuel companies in terms of the change being demanded of them.

This was largely overlooked in many analyses of the EO because it didn't demand change from financial regulators, just told Treasury to work with them to get it. However, all federal financial regulators are independent agencies exempt from direct White House control. But, just because the President asked them nicely as he must doesn't mean the independent agencies – especially those now or soon to be headed by Biden appointees – won't try to do what the boss requests.

Further and still more importantly, the body of the order also directs action from executive-branch departments which are bound by orders from the commander-in-chief. It is here that the EO's most immediate impact – and it's important – will be felt.

Specifically, the order requires the Department of Housing and Urban Development (HUD), along with Agriculture and the Veterans Administration, to redesign federal mortgage programs not only to reduce climate risk, but also to ensure that this risk does not fall disproportionately on communities of color or workers. As FedFin's analysis of the order details, this can be done two ways that are far from mutually exclusive: incentives and/or penalty charges. Our client report details how each of these might work; we conclude that the final package will be incentive-driven for underwriting standards and penalty-driven for disparate impact, a conclusion based on our broader understanding of how HUD Secretary Fudge views market supply-demand dynamics.

Of course, the guarantors these executive-branch agencies directly control aren't the entire U.S. mortgage market – far from it. Fannie Mae, Freddie Mac, and – less directly – the Home Loan Banks also play critical roles. Their regulator, the Federal Housing Finance Agency, is independent and, under a Trump appointee, likely less susceptible to White House blandishment.

Still, FHFA is already well ahead of the banking agencies – it's request for input earlier this year sought views on green policy that engendered extensive comment and many proposals. We expect FHFA to act on them in concert with and likely a bit ahead of broader inter-agency action, although it may well preempt slower agencies when it comes to the biggest source of climate risk: floods.

All of these mortgage-market policy shifts have sweeping ramifications for private mortgage insurance, credit risk transfer structures, portfolio lenders, servicers, and securitizers. To learn more, contact us via return email.

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