



FedFin Daily Briefing

Monday, July 19, 2021

Fed Study: Capital Buffers Proved Procyclical

Using confidential Fed data, a new [FRB staff paper](#) finds that banks that came close to their capital buffers reduced lending to creditworthy small-and-medium enterprises (SMEs), a move not matched by banks with ample capital. Buffers thus did not serve their counter-cyclical purpose in this key sector. Borrowers most adversely affected by reduced credit availability were bank-dependent, companies with relatively new lending relationships, and those whose credit lines expired about the time COVID hit. Exposures to large publicly-traded companies did not change based on a bank's buffer status.

Buffers proved to be procyclical because banks in the study appeared to view them as de facto minimum requirements due to the need to quickly rebuild them, the potential for rating downgrades, and possible impairment of capital distributions. This finding reinforces [FSB findings](#) on a global basis and Fed consideration of how best to encourage buffer drawdowns under stress to support macroeconomic and systemic resilience.

Waters Sets Stage for Housing-Infrastructure Action

Preparing for a full committee hearing tomorrow with HUD Secretary Fudge, the [Democratic staff memo](#) highlights the housing-infrastructure bill from Chairwoman Waters (D-CA) [we analyzed late last week](#). As noted, it focuses largely on public and affordable housing, but also includes provisions regarding fair-housing enforcement, first-generation downpayment assistance, and climate change. None of the other bills lined up for the hearing address broader reform or mortgage-servicing issues, instead focusing on matters such as PACE loans, HECMs, and evictions. However, we expect these issues to come up at the hearing to position riders for a near-term mark-up of the Waters bill and thus will provide clients with an in-depth report following tomorrow's session.

HFSC Dems' Inclusion Solutions: Public Banks, FedAccounts, Expanded CUs

The [majority staff memo](#) on Wednesday's HFSC Subcommittee hearing on financial inclusion indicates that three draft bills advancing a strongly-progressive agenda will be considered at a session bankers hoped would instead focus on Bank On accounts and other access initiatives. The top-priority bill is one from Reps. Ocasio-Cortez (D-NY) and Tlaib (D-MI) to create a public-bank incubator providing grants and technical assistance to new public banks at the state and local level. Importantly, the bill would also grant public banks access to Fed System membership and FDIC deposit insurance. New, advantageous Fed liquidity and credit facilities would also be established for public banks.

Another bill up tomorrow would require the Fed to establish no-fee digital transaction accounts based on the FedAccounts model ([see FSM Report CBDC](#)). A third draft bill would permit federal credit unions to apply to the NCUA to expand their field of membership to include an expanded definition of underserved communities and offer broader business-lending services in them. Both the public-bank and FedAccounts bills will face strong GOP opposition and, if some Democrats join, a tricky path through both mark-up and the House floor. The credit-union bill is likely to enjoy bipartisan support but also draw strong banking-industry opposition. We will provide clients with an in-depth analysis of the Wednesday session.

Biden Highlights Competition EO, "Transitory" Inflation

Making it clear that the Administration is prioritizing its new competition policy, President Biden today highlighted his recent Executive Order ([see Client Report MERGER6](#)), arguing that promoting competition will help drive down prices amid worries about increasing inflation. New businesses, he argued, will be able to enter the market to compete against "giant corporations" that have boosted prices. President Biden further reiterated FRB Chairman Powell's stance that current inflation is transitory ([see Client Report FEDERALRESERVE62](#)), also citing a recent meeting with Mr. Powell in which the President emphasized the Fed's independence; this is of course in sharp contrast to President Trump's frequent [demands](#) that the FRB alter course to suit him.

House Democrats Try Again on Credit-Rating Reform

Renewing a battle Democrats have waged since before Dodd-Frank, HFSC's second subcommittee [hearing](#) on Wednesday will examine draft legislation from its chair, Rep. Sherman (D-CA), to partially nationalize credit ratings. The bill would do so by creating an entity within the SEC that would assign ratings to NRSROs, thus ending the competition for ratings assignments critics believe undermines rating objectivity. The SEC could also govern rating pricing if it deemed this necessary. However, the bill would not establish a government agency actually doing the rating as some [progressive Democrats have demanded](#).

The subcommittee will also assess draft legislation requiring the SEC to adopt rules mandating that the NRSROs implement policies governing how climate-related risks are considered. Also a Democratic [priority](#) predating the current Congress, the bill is aimed at growing concerns surrounding greenwashing and follows a recent [consultation from IOSCO](#) on recommendations for regulatory and supervisory expectations surrounding ESG investments. The subcommittee will also consider draft bills that would significantly toughen SEC enforcement over the ratings agencies, rejecting several SEC actions carried out under previous administrations (e.g., no-action letters).

PWG Plans Stablecoin Report, Risk Recommendations

The readout today of the PWG's [stablecoin meeting](#) emphasizes Secretary Yellen's demand for quick regulatory action. However, the plan announced today is solely a Treasury report with risk recommendations in "coming months." When it comes, this report will presumably narrow down the options presented in the January stablecoin report ([see Client Report CRYPTO16](#)), likely leading to new rules along with calls upon Congress for new law.

In the interim, the agencies -- all represented by top officials -- will surely take a go-slow approach to any applications or other decisions that would front-run the PWG. The most immediate of these include chartering decisions from the OCC on stablecoin constructs that received preliminary approval under the prior Acting Comptroller ([see FSM Report CRYPTO17](#)).

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-071621](#): Later today, we'll provide clients with a summary of key provisions in the [housing-infrastructure package](#) released earlier today by HFSC Chairwoman Waters.
- [FEDERALRESERVE63](#): Signaling a tough challenge for a second Powell term, Senate Banking Chairman Brown (D-OH) today said, "It's time to try something different," also joining Sen. Warren (D-MA) lambasting Mr. Powell's role in what they characterize as risky big-bank regulatory relief.
- [FEDERALRESERVE62](#): Although much of today's HFSC hearing with Chairman Powell was preoccupied by hot debate over the extent to which inflation is "transitory," key financial-policy questions also surfaced for substantive discussion.
- [GSE-071221](#): On Friday, former FHFA Director Calabria [suggested](#) that the Administration's [new competition policy](#) powers up his proposal for authorizing multiple GSE charters just as a bank charter is granted to all qualified comers.
- [MERGER6](#): In an [executive order \(EO\)](#) that truly deserves to be called "sweeping," President Biden today announced a "whole-of-government" initiative aimed at reducing market concentration, enhancing consumer choice, reducing prices, and enhancing economic equality.
- [GSE-070821](#): Our recent in-depth analysis details the range of options proposed by the Financial Stability Board for MMF reform. Here, we assess what this means for Fannie, Freddie, and the FHLBs.
- [GSIB20](#): The House Financial Services Committee has approved legislation introduced by a progressive Democrat, Rep. Ayanna Pressley (D-MA), requiring GSIBs to disclose many quantitative and qualitative matters.
- [MMF17](#): As promised late last year when it addressed nonbank financial intermediation (NBFi), the Financial Stability Board is seeking comment on ways to reduce the risk that money-market funds (MMFs) succumb to runs under stress or, as occurred in both 2008 and 2020, require taxpayer backstops.
- [GSE-070121](#): Continuing to act with awesome dispatch on its new director's racial-equity and economic-equality agenda, [FHFA today](#) issued a final policy statement setting new anti-discrimination standards for Fannie, Freddie, and the FHLBs.
- [GSE-063021](#): With numerous modifications designed to make its [proposal](#) less onerous, the CFPB on Monday issued a [final rule](#) providing temporary foreclosure protection without the *de facto* moratorium that, had the Bureau [heeded](#) some on the Hill, would have prolonged nonpayment, possibly precipitating a flood of borrower requests which servicers could not reasonably be expected to handle with justice for all.
- [FCRA30](#): Today's HFSC hearing on credit reporting laid the foundation for legislative action on measures that will prove highly controversial.
- [GSE-062821](#): After last week's colossal Supreme Court [decision](#), we provided our [first assessment](#) of its impact on near-term charter, mission, and regulatory decisions. Now, we turn in detail to what might come to pass for the conservatorship.
- [CBDC6](#): As previously noted, the BIS has released its most full-throated endorsement yet for CBDC. This not only puts further pressure on central banks – the Fed very much included – to accelerate work, but also on the shape of emerging CBDCs.
- [GSE-062321](#): There is much rejoicing in mortgage-industry land that the Supreme Court decision today

means rapid repeal of Mark Calabria's regulatory legacy and still more rejoicing among affordable-housing advocates about GSEs yoked to a new public-welfare and racial-equity mission without any hope of an end to the conservatorship.

- [CHINA16](#): The Senate has passed by a wide margin legislation taking an array of actions to counter the threat now seen to be posed by the People's Republic of China.
- [GSE-061721](#): We have reviewed FHFA's massive [report to Congress](#) on its 2020 activities, finding only lots of handy facts and no significant policy insights.
- [GSE-061621](#): As [detailed in our new in-depth report](#), the Basel Committee is proposing a new regulatory framework for bank exposures to cryptoassets that will influence not only what banks do in this critical arena, but also what the GSEs can do and thus what happens to the [digital mortgage](#).