FedFin Daily Briefing

Monday, August 9, 2021

FSB: 2009 Comp Standards Withstand COVID, Other Challenges

The FSB's summary today of its latest compensation workshop concluded that most compensation frameworks were flexible enough to respond to the pandemic. Although temporary measures – e.g., adding compensation related to customer satisfaction – were sometimes required, there was generally no need for compensation-framework overhaul. As a result, regulators reported that current compensation policies and guidance such as restrictions on dividends and share buybacks provide the prudential and supervisory tools needed to ensure safety and soundness. No rewrite thus seems imminent of its 2009 guidance (see Client Report **COMPENSATION21**).

The participants also examined non-financial compensation criteria and measures such as variable remuneration arrangements that have increasingly incorporated nonfinancial criteria. Risk-management considerations are the main driver of this trend, with the increased emphasis at banking, insurance, and asset-management firms on culture and societal expectations resulting from choice, not regulation; ESG, reputational, and diversity-related criteria are increasingly used, with firms participating in the workshop expecting this to grow over the next five years.

Fed Staff: Shadow Banks Increasing Gaps in Reg Perimeter

A new Fed Staff paper provides an exhaustive inventory of gaps the in U.S. financial-regulatory perimeter and the risks they present. It finds that the perimeter expanded and became more complex and more permeable starting about three decades ago as regulators responded to new commercial entrants and novel charters by bringing them inside the perimeter. As a result, the rise of the shadow banking system over time added significant complexity due to several hundred regulatory categories, allowing regulatory arbitrage. Although all the new regulatory venues allow regulators to keep a wider range of firms inside at least some perimeter that bans commercial activities, affiliates and parent companies often remain exempt. They thus can profit from financial activities without any commercial constraint.

The study also finds that regulators are generally unable to police efforts by firms outside the regulatory perimeter that compete with regulated firms by offering similar services, presenting still more regulatory arbitrage opportunities. These outside-in "breaches" are found often to be the impetus for changes to the perimeter, with authorities more often than not either expanding the perimeter or plugging gaps to prevent further breaches. With few exceptions, the perimeter is rarely retracted after a breach and regulators tend not to free regulated firms to compete with new entrants. Instead, they attempt to expand the scope of regulation to include new entrants and relevel the playing field.

Fed Study: Climate Change a Risk to Economic Growth, Financial Stability

Describing climate change as the central economic challenge of this century, a new Fed study finds that climate risk may lead to large risks to macroeconomic growth. Warning that economic contractions could become both more likely and severe over time due to climate change, the author concludes that temperature increases are likely to result in lower growth than would otherwise be the case absent these increases. Using quantile regressions on data from 1961 to 2010 from 124 countries leads the author to fear large macroeconomic and financial-stability risks if temperature rises persist.

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-080421**: A new Fed study finds a significant mark-up in the cost of mortgages during the 2020 boom even though government guarantees secured continued mortgage supply for all but the lowest and highest ends of the housing market.

- **REFORM207**: Today's Senate Banking hearing on bank supervision did not include FRB Vice Chairman Quarles, who came before the panel for withering criticism earlier this year (see Client Report REFORM206).

- **GSE-080221:** Whatever befalls the Senate infrastructure bill, we believe its $21 billion GSE pay-for is but one bit of a bigger de facto transformation of the GSEs.

- **GSE-073021**: As promised, we here follow up our assessment of Ginnie's proposed prudential standards for nonbank mortgage companies with an analysis of model rules aimed at the same goal from the Conference of State Bank Supervisors (CSBS).

- **PREEMPT37**: Senate Banking today held a hearing on new legislation (S. 2508) from Sen. Reed (D-RI) extending the Military Lending Act (MLA) interest-rate cap to certain consumer financial products to all consumers.

- **GSE-072821**: Ginnie's proposed new capital and, to a lesser extent, its liquidity standards could well redefine the mortgage playing field.

- **CBDC7**: Today's HFSC National Security Subcommittee hearing on CBDC featured bipartisan concern over China's threat to U.S. Dollar supremacy and the effectiveness of U.S. sanctions without a U.S. CBDC.

- **ACCESS2**: At a very well-attended HFSC Consumer Protection Subcommittee hearing, Democrats strongly supported government-led solutions to increase financial inclusion.

- **VENDOR9**: The banking agencies have proposed sweeping standards that would hold all of the banking organizations they govern responsible for the safety and soundness, consumer compliance, and perhaps even diversity of a wide range of third-party business arrangements …

- **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.

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- **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.

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