Friday, November 12, 2021

FRB-NY Staff: Big-Bank Market Power Argues for Tougher Liquidity Rules, Antitrust Action

In a timely post given ongoing discussions about U.S. competition (see *Client Report* **MERGER6**), a recent Federal Reserve Bank of New York staff note evaluates fire-sale risk in light of financial-sector concentration. As the post points out, virtually all recent work on post-2008 capital and liquidity regulation posits friction-free competition which is an artifact of model convenience, not of market reality. Models thus assume that fire-sale considerations result in externalities such as undue leverage. Based on a detailed paper, the post describes a test of whether competition leads banks to internalize fires-sale price impact. Looking not only at asset concentrations, but also at derivatives-market share to show current U.S. financial-sector concentration, the paper concludes that fire-sale risk is considerably higher than models anticipate because powerful banks avoid immediate recognition of asset-price differentials under liquidity stress and even purchase "fire-sold" assets. Thus, these banks may internalize liquidity-shortage costs, likely leading to still more procyclical crises if stress proves systemic. This leads the authors to recommend tougher liquidity regulation due to current concentration, also urging that antitrust policy assess the liquidity impact of further financial-market consolidation to capture a critical social-welfare consideration. Absent an in-depth assessment of the back-up paper's methodology and data, it is difficult to assess the validity of these conclusions. However, we note that, to the extent large banks internalized liquidity shortfalls in the 2020 COVID crisis, this enhanced systemic stability by virtue of bank ability to support captive MMFs and mutual funds and handle unprecedented deposit inflow.

Senate Democrats Turn to CFPB for Credit-Reporting Reform

Senior Senate Democrats have now upped their demands of credit-reporting agencies and the financial institutions that provide key data, calling on the CFPB to ramp up an array of requirements they believe would enhance financial inclusion. With this letter, it seems clear to us that Senate Banking will take up none of the credit-reporting reform legislation advocates propose, instead keeping up pressure on the Bureau to do as much as possible (and perhaps even a bit more) under current law. Director Chopra recently told Congress (see *Client Report* **CONSUMER37**) that he indeed intends a crackdown even though he does not believe it advisable to create a public credit-reporting agency. Sens. Schatz (D-HI), Brown (D-OH, Wyden (D-OR), and other prominent Democrats suggest the Bureau establish an "ombudsperson" to settle credit-report disputes, consider mandatory accuracy audits, and codify a recent settlement with the state attorneys' general focused on medical debt. The Bureau is also told to take unspecified action to address algorithmic-underwriting bias, with senators noting that the reforms directly addressed are not an "exhaustive list" of actions the Bureau should consider.

Basel Implements Promised Market-Risk Disclosures, Backs Down on Sovereign Weightings

As presaged on Tuesday, the Basel Committee today released new market-risk and voluntary sovereign-debt disclosures. The new market-risk disclosures reflect the 2019 fundamental rewrite of trading-book capital rules (see FSM Report **CAPITAL223**), coming into effect in 2023 consistent with Basel's cautious transition schedule. The sovereign disclosures respond to longstanding Basel concern about the application of zero risk weightings to higher-risk sovereigns (see FSM Report **CAPITAL220**). They do not, as Basel initially contemplated, alter the risk weighting, instead relying on market or supervisory discipline to constrain risk in nations which choose to implement these disclosures. It is unclear if the U.S. will do so in concert with long-awaited action on the entire 2019 "Basel IV" rewrite. This was initially set for consideration over the summer, but there is still no official sign of action, nor is there now likely to be one, until the larger question of Fed leadership is resolved first by President Biden and then in the Senate.

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-111221**: As Mark Calabria made clear earlier this year, reform of the Treasury market has direct, major impact on that for agency debt and MBS.
- **TMARKET2**: In this report, we build on our initial analysis of Monday's report from the Inter-Agency Working Group on Treasury Market Surveillance (IAWG).
- **SYSTEMIC92**: Late yesterday, the Federal Reserve released its most recent financial-stability report. As in its predecessor earlier this year (see *Client Report* **SYSTEMIC91**), this report takes a cautious view, counting on continuing bank resilience to counteract old worries, such as asset-price bubbles, along with containing at least some new fears.
- **CRYPTO21**: As noted yesterday, the President's Working Group on Financial Markets (PWG) was joined by the OCC and FDIC yesterday issuing a report calling for prompt Congressional action to regulate stablecoins and, even in its absence, also for fast action by federal regulators and the FSOC.
- **GSE-102821**: FHFA is proposing a new disclosure regime designed to bring Fannie and Freddie into the public marketplace in a fashion analogous to large U.S. banks.
- **CONSUMER37:** As anticipated, HFSC's hearing today with CFPB Director Chopra skidded over a wide range of policy issues.
- **GSE-102721:** After years of enforcement inactivity, the OCC has issued a tough set of restrictions against one of the increasingly few large mortgage servicers still willing to be a banks.
- **GREEN11:** As we noted yesterday, the Financial Stability Oversight Council has now complied with President Biden's executive order (see FSM Report **GREEN8**), compiling an exhaustive assessment of the financial-stability implications of climate risk and what might best be done about it.
- **CBDC9:** Shortly after the BIS and a group of central banks endorsed a construct for retail-facing central-bank digital currency (CBDC), the Group of Seven (G7) finance ministerial issued these public-policy principles to establish a still broader framework for future action
- **SANCTION15:** Today's Senate Banking hearing with Treasury Deputy Secretary Wally Adeyemo showed bipartisan concern that the Administration is failing to implement sanctions required by law, especially when it comes to China, North Korea, and Russia.
- **MMF18:** Global regulators have now finalized a framework on which national regulators may base the reforms they deemed necessary after the pandemic sparked profound disruptions in this sector.
- **CRYPTO20:** Responding to requests from the G7, G20, and FSB, this report addresses market-infrastructure considerations related to systemically-important stablecoins that do not involve multi-currency baskets (e.g., Facebook's Diem).

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- **GSE-101221:** Although the majority of FHA ARMs are now LIBOR-linked, HUD has been waiting for Congress, the Fed, or forces on high to help it set a new benchmark.

- **MERGER8:** Progressive Democrats in the House and Senate have introduced legislation demanding an array of new decision factors governing bank M&A transactions and new or even revised BHC activities.

- **INVESTOR19**: As anticipated, today's HFSC hearing with SEC Chair Gensler covered the full SEC agenda, although members steered clear of the SEC investigation demanded by Sen. Warren (D-MA) into recent Fed trading.

- **CBDC8**: As we noted last week, the BIS and seven major central banks have advanced global CBDC policy with three new reports evaluating key design features.

- **GSE-093021a**: Now that we have FHFA's comment deadline – November 26 – we expand our initial analysis of FHFA's capital rewrite into a more detailed assessment of its strategic impact.

- **REFORM209**: In very sharp contrast to the Senate Banking session on Tuesday with Chairman Powell and Secretary Yellen (see Client Report **REFORM208**), today's HFSC session was largely devoted to partisan wrangling over monetary policy, the debt ceiling, and the Biden Administration's overall fiscal policy.

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