Wednesday, November 24, 2021

# GSEs Get Greener

## Summary

Because FHFA tends to take its cue from both the Basel Committee on Banking Supervision and its U.S. cousins, we here drill down to look at the housing-finance implications of the proposed global framework we assessed in a recent in-depth report. Although Basel's standards are only high-level principles and even then not yet final, we expect this framework to combine with work under way at the Fed and OCC to pressure FHFA to speedier action on express climate-risk governance and scenario-analysis requirements.

## Analysis

Following the FSOC climate-risk report required by the President's climate-risk order, FHFA Director Thompson endorsed the need for physical and transition risk controls without offering any specifics on the how-to front.

So far, FHFA under her leadership has instead emphasized equitable finance, fair lending, affordable housing, and regulatory capital. This is indeed a formidable agenda, but climate risk is such a hot political issue at the White House that we expect FHFA quickly to add it to the list as global and U.S. regulators demand more of the biggest banks.

As with the OCC, the easiest near-term action for FHFA is to tell the GSEs and Home Loan Banks to get their climate-risk governance in good order. The OCC is easing into this by instructing national-bank boards to quiz management on the key governance issues also detailed in Basel's principles. Given the conservatorship, the distinction between regulation and corporate governance is a good deal blurrier at the GSEs, but FHFA may still issue some governance injunctions or make public any it has sent over so far. At the least, governance guidance is a sign of specific action that delays more binding but analytically complex ones; at best, it moves the needle at each of the GSEs and Home Loan Banks.

Both the OCC and FRB also plan near-term climate-risk supervisory guidance for the biggest banks. These statements will go beyond governance also to address an array of credit, counterparty, concentration, market, and operational risks. As with Basel's principles, there will be heavy emphasis on the need for policies and procedures addressing key concerns rather than on specifics as to what these policies and procedures should be. The standards will also surely urge risk mitigation wherever possible without saying when regulators think that might be.

The trickiest near-term issue is scenario analysis. Basel suggests that supervisors can quickly demand that bigger banks undertake these exercises ahead of more binding stress tests. U.S. regulators are far less sanguine, almost surely holding off on mandating them until well into 2023.

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It could be argued with some justice that scenario analyses are less challenging for the GSEs and Home Loan banks than for cross-border, diversified banking organizations. Some in the White House, Congress, Treasury, or outside advocacy groups may soon say so. However, we think FHFA will be in good company with the Fed on this front and thus have a credible defense against imminent scenario-analysis requirements unless the agency on its own decides to accelerate its work in this high-profile arena.

## Outlook

Basel defers action on stress tests even though some member nations are already moving these forward and it is even less ready to bless the new climate-risk focused capital framework some in Congress demand and even the Bank for International Settlements has explored. U.S. regulators are also putting any and all binding climate-risk standards along these lines on hold at least until the SEC finalizes climate-risk disclosures aimed at investors that many believe will introduce a new era of comparable, reliable climate-risk data. We think FHFA thus has plenty of company on a go-slow path to any climate-risk rules that go beyond governance and guidance.

However, confirmation deliberations are complex arenas in which climate-risk will figure prominently as long as Democrats make these decisions. As a result, for all the impact of each of these global and banking-agency developments, the outlook for near-term GSE action remains uncertain.

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