FedFin Daily Briefing

Tuesday, August 23, 2022

## Life Insurers Depend on FHLB Advances for Stress Liquidity, Long-Term Funding

Reflecting longstanding fears about life-insurance run-risk (see *Client Report* **SYSTEMIC92**), a new research note from the Federal Reserve finds that life insurers were quick to establish liquidity buffers when Covid hit in 2020, largely doing so via FHLB advances and interest-rate derivative margins. None of the steep increase came from asset sales, likely because insurance Treasury holdings are small and about half are encumbered. After the financial crisis eased, life insurers generally kept their elevated FHLB holdings and used them to invest in other assets or substitute for other liabilities. As previously noted, life insurers are major FHLB borrowers and one insurer – MetLife – is the System's biggest. The study concludes by noting life-insurance industry dependence on the Home Loan Bank System and the challenges determining liquidity from current filings. It notes that the NAIC is now conducting an analysis of industry liquidity and commends it for doing so and taking account of Treasury-asset encumbrances. The note does not address growing questions about the FHLB mission but may well be referenced as FHFA continues its "listening sessions" on this issue.

## JEC Financial Inclusion Report Calls for Postal Banking, Crypto Regulation

The Joint Economic Committee yesterday afternoon released a report on the barriers that people of color and low-income communities face accessing financial services, concluding that traditional banks discriminate, new nonbank offerings may prove predatory, and policy solutions are essential. The report supports the CRA rewrite (see FSM Report **CRA32**), presses for alternative credit-risk assessment models, and urges the establishment of a postal banking system akin to that proposed in longstanding Gillibrand legislation (see FSM Report **POSTAL9**). Citing the risk of crypto scams and price volatility, the JEC report also supports legislation introduced by the panel's chairman, Rep. Beyer (D-VA) as H.R. 4741 to incorporate digital assets into the existing financial regulatory structure. The report also states that minority borrowers are more likely than their white counterparts to have their applications rejected. Fintech is said to have potential to improve inclusion, but its algorithms have failed to eliminate racial bias as evidenced by the fact that Blacks and Hispanics pay higher mortgage interest rates on fintech platforms.

## OFR: Lower-Risk Hedge Funds Lead to Higher Treasury-Market Stress

A new OFR working paper finds that changes in aggregate hedge fund exposures are related to Treasury yield changes in economically and statistically significant ways, with managed futures and multi-strategy funds having the highest impact on Treasury prices. In contrast to conclusions from prior studies, this paper also finds that more highly leveraged funds have the weakest price impact in Treasury markets. Although 2020 is covered by the study, this result may be due to the longer time periods studied. The paper notes that, while hedge funds do not solely drive price fluctuations in the Treasury market, they may have amplified stress during the March 2020 financial crisis by contributing to large fluctuations in Treasury yields and liquidity decreases. The study uses confidential hedge-fund data from the SEC on a month-to-month basis from 2013 to the fourth quarter of 2020 to calculate hedge-fund aggregate and net Treasury exposures (including cash bond and derivative positions) and their fluctuations. The report draws no policy conclusions, but it also notes that concern about hedge-fund risk appears to increase investor pricing demands, increasing the cost of issuances in ways likely to continue Treasury's focus on hedge funds as it considers market-reform initiatives and the SEC looks for more data on this sector.

# FHFA Advances Equity Campaign with New Committee

Building on its equitable housing campaign, FHFA today announced an advisory committee on affordable, equitable, and sustainable housing. It will provide analysis focused on Fannie, Freddie, and the FHLBs in areas such as the barriers to and need for regulatory or policy changes to expand affordable, equitable, and sustainable housing. FHFA is looking for candidates with experience in fair housing, single or multifamily lending, consumer advocacy, market technology, state or local housing policy, and/or housing research. The Committee's charter will be published in the *Federal Register* fifteen days after publication of the notice of intent.

## 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.

- **CRYPTO31:** Reflecting the concerns voiced in a recent executive order from President Biden and a subsequent request for views from Treasury, the Federal Reserve has joined the OCC in demanding prior notice from banking organizations that wish to undertake cryptoasset activities.
- **GSE-082222:** A new Federal Reserve Bank of Cleveland study validates forbearance as a mortgage-market buffer, reinforcing the likelihood that policymakers and servicers will turn quickly to it if current mortgage-market conditions turn ugly under the combined stress of higher rates and slow to no growth.
- **GSE-081922:** We look here at an interesting idea from three senior Fannie Mae officials: an index to measure a Single-Family MBS's social impact.
- **PAYMENT25:** Following considerable controversy surrounding how Federal Reserve Banks grant master accounts, it has finalized a somewhat more explicit set of guidelines along lines proposed the second time the Fed attempted to set guidelines via a "supplemental" proposal earlier this year amending its 2021 effort.
- **GSE-081722:** FHFA and Ginnie Mae today let loose their long, long delayed standards for eligible seller-servicers.
- **INFOSEC28:** Using another of its tools to set policy without prior public comment, the CFPB has released a circular stating that inadequate consumer-data safeguards may constitute a breach of the unfair, deceptive, or abusive acts or practices (UDAAP) protection standards subject to Bureau enforcement action.
- **FINTECH30:** Continuing its practice of setting sweeping policy by administrative action without prior notice or comment, the CFPB has issued an interpretive rule sharply curtailing the extent to which digital

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- **GSE-081222:** FHFA, Fannie, and Freddie yesterday released the results of FHFA's latest stress test, focusing on the severely-adverse scenario in order – or so FHFA says – to push the GSEs to the limit.

- **INTERCHANGE10:** Two senators have reopened questions about the manner in which card-related payments are handled, tackling those applicable to credit cards with a bill mandating that merchants must be given a network choice that is not either Visa or Mastercard in order to, the sponsors argue, increase competition and lower credit-card transaction costs.

- **LIBOR8:** Moving belatedly but now expeditiously to implement legislation governing legacy-contract benchmarks when there is no contractual fallback rate, the Fed has proposed a new framework for derivatives, consumer loans, certain GSE contracts, and any other legacy contracts without clear LIBOR-replacement provisions and a "determining person" to effectuate them.

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