FedFin Daily Briefing

Friday, September 30, 2022

Brainard Acknowledges Risk But Sticks to Policy Guns

Responding to acute concerns that Fed policy will shatter global financial stability, Fed Vice Chair Brainard today emphasized her longstanding and once-isolated view that monetary policy must consider financial stability. However, like Chairman Powell, she attributes much instability and inflation to externalities such as Russia's invasion. Although she does note that Fed policy amplifies monetary actions in other nations, the vice chair also notes positive contribution of counter-cyclical capital buffers outside the U.S. as protection against financial instability – a reminder of Ms. Brainard's longstanding advocacy of a U.S. CCyB and an indication that one is likely to be triggered in the U.S. when conditions normalize. Noting the Fed's commitment to curbing U.S. inflation, these financial-stability concerns will not, she suggests, alter the Fed's course to tighten for "some time," although the Fed is cognizant of the need also to match monetary policy with effective macro risk management.

Global Standard-Setters Turn to Clearing Margin, Liquidity

The Basel Committee, IOSCO, and CPMI issued the first substantive response to the FSB's decision to target margining practices following its review of the 2020 financial crisis and the need to address nonbank financial intermediation (see *Client Report* **NBFI**). The report provides additional data describing stresses caused by wide swings in variation margins during the "dash for cash," recommending six policy responses the FSB will now take up. These call for greater central-clearing transparency regarding margining practices and governance that could include ex ante and retrospective analytics and disclosures to both clearing members and the public to reduce procyclicality. The global standard-setters also want the FSB to find ways to ensure that NBFIs have greater liquidity, perhaps by way of disclosure requirements or other actions demanded by clearing members. The report also presses for data gaps in NBFI regulatory reporting, steps to improve post-trade allocations and intraday variable or initial margin payments, and an array of new disclosures and liquidity protocols for non-centrally-cleared markets. Many of the recommended steps are voluntary for market participants and the extent to which CCPs, clearing members, broker/dealers, and large banks will be willing to adopt them is unclear. At the least, action implementing these recommendations is sure to be slow.

HFSC Republicans Denounce Beneficial Ownership Rule

HFSC Ranking Member McHenry (R-NC) and Rep. Luetkemeyer (R-MO) released a statement today sharply criticizing FinCEN's beneficial ownership final rule as overly broad and complex. They argued that, while the rule acknowledged some of their earlier complaints, a significant gap remains between the final rule and the framework mandated by the Corporate Transparency Act, in part because it fails to balance civil liberties and the needs of law enforcement and does not minimize its impact on legitimate small businesses. This will not affect FinCEN's plans to implement its standards but presages legislative oversight and even revision to underlying law if Congressional control changes hands after the mid-terms.

Basel Concludes High Capital Compatible with Sustained Profitability

The Basel Committee today released its latest report on bank capitalization, finding that profitability remains robust despite capital ratios increasing to the highest level since the beginning of the exercise in 2012. This finding buttresses those such as Vice Chair Barr seeking to ensure that U.S. big-bank capital remains at least at its current levels as regulators implement remaining Basel III/IV regulation. The Basel results show that by December 2021 Group 1 – the largest banks – had after-tax profits of $310 billion, total accounting assets of $93 trillion, a TLAC shortfall 2022 minimum of $8.5 billion, and a CET1 ratio of 13.3 percent. The LCR of Group 1 banks decreased from 143.8 percent to 141.3 percent, the average NSFR increased from 124.5 percent to 125.1 percent, and the leverage ratio increased from 6.3 percent to 6.4 percent.

The average impact of the final Basel III framework on the Tier 1 market risk capital of Group 1 banks is lower (+2.4 percent) compared to the 3.3 percent increase at end-June 2021. The total capital shortfalls under the fully phased-in final Basel III framework as of end-December 2021 reporting date for Group 1 banks decreased to $130 million compared to end-June 2021, now standing at only $2.6 billion. The report also found that the capital conservation buffer (CCoB) requires the most capital, followed by the G-SIB buffers, other Pillar 1 buffers and Pillar 2.

Bowman Comes Out Swinging on New, Costly Big-Bank Rules

Following a speech earlier this week largely siding with banks on merger policy, FRB Gov. Bowman today agreed with assertions from bank CEOs (see *Client Report* **REFORM213**) and others that the largest U.S. banks are now well capitalized as judged by ratios and effective stress testing. Signaling both her willingness to work with the new Fed supervision vice chair and only to agree with him on changes that "make sense," Ms. Bowman also argued that regulatory and supervisory refinements must carefully balance between safety and cost. Over-regulation at a time of rising rates could, she said, suppress economic growth and she thus pressed for changes to the stress-test regime to increase consistency and fairness, opposed imposition of TLAC on regional banks as a condition of merger rather than via broad-based rulemaking, urged flexible supervisory standards for cryptoassets that permit banks to engage in digital-asset activities, and pressed for greater supervisory clarity and transparency to limit the need for enforcement actions.

FRB/FDIC Turn to Regional Resolvability

The Fed and FDIC today announced that they will shortly propose resolution guidance for most regional banks. There is no indication in the announcement of timing or context, but we expect this guidance to include the TLAC standards we recently assess in a client update. This guidance would appear to cover all categories II and III banks under the tailoring rule (see FSM Report **SIFI34**), not just those seeking to acquire another banking organization, accomplishing the transparent, ex ante framework advocated earlier today by FRB Gov. Bowman; the Board vote for this guidance was unanimous. The guidance will also be released for public comment before it is finalized. It is unclear if this approach will satisfy super-regional resolvability concerns that are among the reasons several large deals are delayed, but it would ensure that BHCs allowed now to acquire a banking organization would need quickly to come to terms with living-will requirements applicable across the sector regardless of M&A activity. As a result, a super-regional holding company allowed now to acquire a bank would need quickly to comply later.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com

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.

- **MORTGAGE121:** The CFPB has asked for views on the extent to which it can facilitate certain refinancing (refi) products it believes enhance economic justice.
- **GSE-092622:** As will be evident in our forthcoming in-depth analysis, the CFPB's fusillade last week on mortgage-finance could have far-reaching implications for the entire market based on how far it takes its new campaign for equitable housing finance and whether the market is willing to come along on at least some of the agency's new ideas.
- **AML136:** Treasury is seeking comments on issues raised by the President's executive order (EO) on digital assets to guide further work curbing illicit-finance and national-security risks in this sector.
- **REFORM213:** Senate Banking's hearing with big-bank CEOs proved much more combative than HFSC's session yesterday (see *Client Report* **REFORM212**).
- **GSE-092222:** In this report, we follow our earlier analysis of Treasury's CBDC recommendations and housing finance with an analysis of another Treasury report in response the President's executive order focused on the overall construct of cryptoassets in the U.S.
- **REFORM212:** At today's big-bank oversight HFSC hearing, Committee Democrats focused on each bank's progress on social issues, such as internal diversity, unionization, and historic roles in financing slavery.
- **GSE-092122:** In this analysis, we drill down in Treasury's high-impact reports to the President on the future of digital assets to identify key considerations and strategic implications for housing finance.
- **CRYPTO32:** We follow our prior in-depth analysis of Treasury's CBDC and payments report (see *Client Report* **CBDC14**) with a detailed assessment of the Department's assessment of overall cryptoasset policy.
- **SANCTION19:** Today's Senate Banking hearing on Russian sanctions showcased bipartisan concern that anti-Russian sanctions have yet to have meaningful impact and doubts about the extent to which oil-price caps will reverse this.
- **CBDC14:** In this in-depth report, we follow through as promised on our initial analysis of key sections in last Friday's Treasury report on CBDC and changes to the payment system.
- **INVESTOR20:** The Senate Banking hearing with Chairman Gensler today went as expected: Democrats generally praised his work while Republicans strongly opposed it on both substantive and procedural grounds.
- **INSURANCE61:** Chairman Brown (D-OH) convened a hearing today focused on the insurance industry largely focusing on the extent to which private-equity takeovers endanger insurance solvency and threaten pensioners following risk transfers.
- **GSE-090722:** Reinforcing the sharp turn-around in housing markets evident since the Fed surprised

markets with its first 75 bps hike, a new working paper from the San Francisco Fed provides the first hard evidence of how monetary-policy shocks in the U.S. hit listing prices hard and fast.

- **GSE-090122:** As seems always the case, FHFA Director Thompson is as good as her word to Congress earlier this summer, announcing yesterday a review of the extent to which the Home Loan Banks and their System meet the mission assigned to them and, regardless, if that mission still makes sense.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com