FedFin Daily Briefing

Tuesday, October 4, 2022

IMF Calls for Open-End Fund Swing Pricing

The IMF today released a study of open-end funds sure to guide the action promised by SEC Chairman Gensler (see *Client Report* **INVESTOR20**). The study concludes that liquidity mismatch vulnerabilities in open-end funds pose a financial-stability risk and recommends that policymakers eliminate swing pricing caps and improve data monitoring and transparency. If swing pricing is not possible in a jurisdiction, then the Fund recommends closely linking the liquidity of underlying assets to the liquidity provided to investors. Notably, Felix Suntheim of the IMF indicated that these policy cautions are even more critical because open-end fund liquidity has deteriorated while monetary policy is tightening, increasing fund vulnerability. Among the most controversial proposals in the SEC's MMF-reform proposal (see FSM Report **MMF19**) is swing pricing; we expect the Fund's endorsement for open-end funds not only to influence forthcoming action in this sector, but also the final MMF standard.

Fed Study: Climate-Risk Insurance Cross-Subsidies Pose Moral Hazard, Financial Risk

Using homeowners' insurance as a proxy for climate-risk insurance, a Fed staff study finds that the decoupling of rates and risk raises moral hazard and causes policy-holders in lower-risk and less restrictively regulated states to subsidize those in riskier states, where rates have been outpaced by losses. The authors also conclude that this cross-subsidization may not prove sustainable, noting the greater availability of cheaper insurance in high-risk markets could carry significant long-term financial and social risks. We would note that these financial risks may affect climate-risk management considerations by lenders and guarantors who now count on insurance coverage as a significant climate-risk mitigation tool. These conclusions are derived from novel data on insurers' historical rate filings, which are then used to divide regimes into "restrictive" ones that sharply constrain premiums and less-restrictive ones that do not do so. The difference between insurance-firm determinations of actual climate risk and the extent to which premiums capture these drives the market distortions identified here.

Yellen Highlights Need for Crypto Reg at Racial Equity Roundtable

At a Treasury roundtable on racial equity and economic inequality, Treasury Secretary Yellen today reiterated the importance of the cryptoasset standards recommended yesterday by the Financial Stability Oversight Council. As detailed also in recent Treasury reports (see *Client Report* **CBDC14** and see *Client Report* **CRYPTO32**), Ms. Yellen emphasized the importance of consumer protection, noting that there is enormous crypto market volatility and these assets lack FDIC insurance protections. She called for additional cryptoasset regulation to provide a safe framework for consumers. It is unclear if the new racial-equity council established today will focus on financial-policy considerations, but this seems unlikely given its broader agenda. In conjunction with this event, HUD has also released an RFI on ways to increase small-dollar mortgage finance; we will shortly provide clients with an in-depth analysis of this first step to new FHA policy.

Fed Sets Supervisory Standards for a Non-Traditional IDI Parent

The *Federal Register* today includes the Federal Reserve's final supervisory framework for DIHCs controlled by insurance companies. Substantially the same as the proposal (see FSM Report **INSURANCE60**), the final rule may prove to be the framework used by the Fed for all insured depository parent companies that are not traditional BHC's, most immediately S&LHC's controlling broker-dealers. The new approach sets supervisory ratings designed to reflect the DIHC's business model, tailoring Fed intervention based on the firm's complexity and size. The standards also aggregate subsidiary capital requirements and thus defers to primary regulators, here of course state insurance commissioners. However, it also has top-down capital standards that may require some firms to increase capital or liquidity. However, with this new holding-company construct, the Fed may be more inclined to approve merger or other expansion applications for DIHC's and similar holding companies once it finalizes its overarching merger policy. The DIHC standards are effective on November 3.

Final FHLB Listening Session Brings System Praise, Resistance to Change

We will shortly provide clients with an in-depth report on the last session FHFA held today listening to dozens of views on the future of the Federal Home Loan Bank System. As our in-depth assessment of the first two days made clear, FHFA has an abundance of differing views from which to choose. As in the last session, today's witnesses addressed the systemic risk apparently considered by FSOC at its September meeting, with virtually all comments supporting the System as is or with a still larger role supporting bank liquidity, affordable housing, and community finance. FHFA's next step is to accept written comments until October 21, following which it will convene regional listening sessions and otherwise take its time deciding what, if anything, to do differently with the Home Loan Banks.

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-100422:** Although one witness at the FHFA listening session on the Home Loan Banks took strong issue with their mission and meaning, another who called them the "most successful program of the last hundred years" pretty much summed up today's testimony.
- **GSE-100322:** Our take on the first two days of FHFA's FHLB "listening session" last week is that battle lines are shaping up much as we expected with the exception of a couple of powerful groups with new ideas about how the System could be put to better use for themselves and/or the public interest.
- **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.

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