FedFin Daily Briefing

Friday, March 10, 2023

Anti-Woke Is Worse Than Woke When It Comes To Financial Distortion

A new study released by the Federal Reserve Bank of Chicago concludes that anti-woke policies distort financial outcomes by looking at 2021 Texas law prohibiting municipalities from conducting certain businesses with financial institutions that violated the law's anti-woke criteria. The study focuses on banks because they are deemed to have the largest impact on credit allocation. In Texas, five of the seven largest bank municipal-bond issuers left the state. Reduced competition then cost municipalities as much as $500 million more in additional interest in borrowings over the first eight months following enactment. This may be a particularly acute result due to the sudden implementation of the Texas law and the need to market Texas munis outside the state since it lacks an income tax, but the study argues that the nature of the muni-bond market and Texas law also make it an excellent case study of short-term impact in a critical sector. The paper notes that bank influence could also distort financial outcomes when banks choose to allocate credit for ESG purposes (e.g., re fossil fuel, firearms), going on to suggest that ESG-based decisions regarding fossil fuel may have long-term public-welfare benefits despite near-term, adverse impacts on communities dependent on less-sustainable economic activity.

CFPB Opens Mortgage Servicing to Regulatory Rewrite

The CFPB today published an RFI seeking the effect of TILA mortgage loan originator rules on small businesses as part of a regular ten-year review. Although nominally focused on small companies, the RFI in fact begins a sweeping review of this sector, with the Bureau asking for comment on how new technologies or market conditions have changed the regulatory construct. Comment is due 45 days after publication in the *Federal Register*.

FedFin Assessment: SVB's Failure And Its Aftermath

As clients will recall, we predicted Silvergate's failure, but not its contagion risk for Silicon Valley Bank, which failed earlier this morning following the combination of a run and capital shortfall. Karen Petrou's forthcoming memo will address the causes of the collapse and long-term policy implications, which are significant not only because of lessons suddenly relearned, but also the certain political response to the fact that the agencies appear to have been totally blindsided by each bank's vulnerability and then imminent failure. Importantly, the FDIC has put SVB into receivership, not a conservatorship that would have protected uninsured depositors, making it clear that the FDIC is moving forward on the policy objectives laid out in its draft merger policy (see FSM Report **RESOLVE48**) to avoid resolutions that reward moral hazard. It is likely for this same reason that the FDIC did not also deploy a more usual purchase-and-assumption transaction in which a large bank buys both liabilities and assets at a significant FDIC discount. However, current market circumstances combined with the nature of each of these banks to make their franchise value almost wholly dependent on a single sector – crypto for Silvergate, VC for SVB. Many post-crisis rules applicable even to relatively small banks and BHCs were designed to capture these risks along with those of deposit concentrations and HTM-asset related illiquidity, but examination proved insufficient and the rules may well get the usual make-over after failure with significant impact even for banks that do not run like-kind risks because of more thorough adherence to applicable standards. Congress is sure to weigh in quickly on these considerations and with political considerations thus added to those we initially outline for regulatory and resolution policy.

Again, these are initial conclusions; an in-depth report along with Karen's memo will follow.

SVB Rumors Stoke Treasury Response

Following the sudden failure of Silicon Valley Bank, Treasury Secretary Yellen today convened the heads of the Fed, FDIC, and OCC to discuss its ramifications. In the meeting's readout, the Secretary expressed confidence in the banking system's resilience and in the tools available to regulators to address the failure. The other agencies have yet to make statements, but continuing earned social media coverage of the bank's collapse is putting pressure on other banks not only in terms of market capitalization, but limited runs at institutions deemed to be more vulnerable.

Congress Begins SVB Inquiry

In the first of a series of statements sure to come from Congress, HFSC Ranking Member Waters (D-CA) today said that she was alarmed by the collapse of SVB and that she is monitoring and convening Committee members with regulators. She cannot of course now set HFSC's agenda based on the findings of any such meetings, but we expect Chairman McHenry (R-NC) and Brown (D-OH) to do the same, quickly convening briefings and then calling hearings to determine how much of the risks posed by Silvergate and SVB's failures are due to banking-agency errors or the construct of current law. As we haven noted, this among other things requires the FDIC to implement "least-cost" resolutions that make it challenging to rescue uninsured depositors when a failing bank's franchise value does not support serious bids. Law and policy designed to prevent banking-industry consolidation and banking/commerce integration also play a role in resolution policy, with the FDIC here likely unwilling to sell SVB to a much larger bank even had any wanted it.

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-030923:** As detailed in our reports earlier this week on Powell's appearance before Senate Banking and HFSC, much was said about the pending rewrite of big-bank capital standards.
- **FEDERALRESERVE73:** At today's HFSC hearing, Chairman Powell modulated his hawkish stance just a bit, continuing as he long has done to refuse to take a stand on fiscal policy while advocating for rapid debt-limit action.
- **FEDERALRESERVE72:** Although Chairman Powell's testimony kept exclusively to monetary policy, today's Senate Banking hearing seemed only to go through the motions set at previous hearings with regard to inflation, growth, and the Fed's long-term objectives.
- **GSE-030123:** A recent FRB-Atlanta study finds that closing the racial homeownership gap alone would not redress housing market racial disparities because minority homeowners cannot equitably access home equity and thus enjoy comparable access to the economic opportunities afforded by homeownership.
- **SANCTION20:** In a remarkably bipartisan session, the Senate Banking Committee today made it clear that Congress wants tougher sanctions against Russia, near-term action against hold-out nations to oil-price caps and other efforts, and perhaps even confiscation of Russian assets to fund U.S. Ukraine aid.
- **CRYPTO40:** In the wake of revelations by Silvergate and other banks about significant deposit exposures to cryptoasset entities, federal banking agencies have issued a statement about the need to manage liquidity risk associated with cryptoassets.
- **GSE-022723:** FHFA has proposed a set of refinements to the current GSE capital construct.
- **CUSTODY5:** Making full use of powers granted in the 2010 Dodd-Frank Act, the SEC is proposing a wholesale rewrite of the rules dictating how investment advisers must place assets in custody and which institutions are considered qualified for this purpose.
- **GSE-022123:** As we noted, FHFA is venturing onto treacherous political ground with a request for input on expanding Fannie and Freddie's ESG imprint.
- **CRYPTO39:** Although Chairman Brown (D-OH) remained non-committal on the need for crypto legislation, he emphatically called for reform to protect consumers and investors.
- **GSE-021323:** Following our initial report, we turn here to a more detailed analysis of what's in store for the Home Loan Banks following the Brookings high-impact forum on Home Loan Banks that are also facing far more unflattering public attention than has been their fate for years.

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