GSE Activity Report

Thursday, March 9, 2023

Now What?

Summary

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. As we've noted, this matters a lot to the comparative advantage of GSEs, nonbank mortgage players, and banks large and small. As a result, we here go in depth on what Powell said – and mostly didn't – about what's next on these critical standards.

Impact

There are two revisions to capital rules in play: "end-game" rules implementing a U.S. version of Basel's 2017 rewrite of the global capital accord and cleaning up some neglected changes along with a "holistic" review of the entire capital regime sparked by Fed Vice Chairman Barr. Virtually all of the flutter at the Powell hearings was focused on the holistic review based on Barr's recent comments that big banks need a good deal more capital. Republicans on both Senate Banking and HFSC were at great pains to say, in essence, no they don't.

Powell danced over this minefield as adroitly as usual, recognizing the trade-off between capital and credit availability and the contradiction between frequent Fed assertions that big banks are capital resilient and the need for tougher new standards. He had absolutely no difficulty promising that the holistic rules will be tailored because that's what the end-game rules will also be, nor did he demur on demands for public notice and comment – the Fed always planned to release proposals and so it will.

Republicans would have been satisfied but for the fact that Powell didn't accommodate them when it came to a promise that nothing Barr does will advance without consensus agreement by the entire Fed Board of Governors. Noting first that he alone cannot throttle Barr's capital plans, Powell promised only that the Fed would do its best to come to agreement as capital rewrites advance.

And so they will, starting in the next few weeks with the complex end-game proposals the U.S. has decided not to defer until completion of Barr's epic efforts to make all of the rules make sense together all of the time. For all the talk of tailoring, some of the end-game proposals will apply to banks big and small because small banks want some of the changes to the standardized approach – i.e., re mortgages – and bank regulators think they need some of the others – i.e., re higher risk CRE and corporate loans. As we have noted, the new mortgage standards could significantly erode the GSEs' capital advantage for lower-risk portfolio mortgages and bank-guaranteed risk transfers. They also bode ill for MIs and HLTV structured products.

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Outlook

Most of the other changes to U.S. rules in the end game will indeed apply only to big banks and big banks do not like most of these other changes any better than higher capital by way of the holistic review. But they will get higher capital requirements not only at the start of the end game for Basel, but also by virtue of incremental steps towards holistic rules such as the Fed's recent revamp of the all-important stress capital buffer. The higher risk-based capital rules go for complex holdings, trading-book assets, off-balance sheet structures, and operational risk; the better low-risk, low-cost mortgages will look if – and this is always a big if – banks navigate return on risk-adjusted capital with the bottom-line leverage standard. All but the GSIBs should be easily able to do so because their leverage requirement (3%) is smaller than that applied to GSIBs and at least one super-regional (5% at the BHC). And, with mortgage rates finally promising a nice NIM, even GSIBs may finally see their appeal.

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