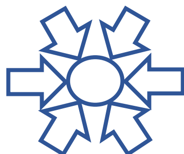

FedFin Daily Briefing

Thursday, April 13, 2023

KC Fed: AOCI Recognition Boosts Credit Availability

A new staff study from the Kansas City Fed finds that significant holdings of unrealized losses adversely affect loan growth in addition to posing the solvency challenges all to evident in recent failures. The channels through which dampening occurs are first higher equity costs due to investor perceptions of greater risk and lower return. Debt-funding costs are also likely to rise, with higher capital and liquidity costs then passed on to borrowers in terms of higher rates that reduce demand. In addition, banks with large unrealized losses may be reluctant to raise capital, also reducing M&A options leading to poorly-allocated and/or reduced lending. As the paper notes, these effects are evident at banks of all sizes, with community and other smaller institutions at greatest risk because of their insulation from market discipline and potential loan covenants or other constraints. The paper deals only with unrealized losses on securities, demurring any policy recommendations. However, its conclusions may give those hoping to reinstate AOCI regulatory-capital recognition an additional argument with which to counter concerns about capital volatility and the challenges of also recognizing unrealized gains in bank liabilities.

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-041323:** As we noted earlier today, global regulators are rethinking their 2015 decision not to require an express capital charge for interest-rate risk, a shift with significant implications for the role of U.S. banks as mortgage lenders and investors.
- **IRR8:** As we noted yesterday, the head of the Basel Committee has targeted two capital and liquidity compromises included in the current Basel III construct not addressed in the end-game rules to which the U.S. plans shortly to turn.
- **COMPENSATION35:** Executive compensation incentives have proved among the most important reform priorities in the wake of recent bank failures.
- **REFORM220:** In this report, we drill down on prior forecasts (see *Client Report* **REFORM219**) of near-term regulatory action to identify the revisions sure to be prioritized as NEC Director Brainard and FDIC Chairman Gruenberg seek to reverse rules finalized over their objections when they were in the minority.
- **UDAP8:** Following its usual practice of setting standards by edict, the Bureau of Consumer Financial Protection has laid out an extensive framework that brings a wide range of consumer-finance actions and inactions within the scope of enforcement sanctions governing acts or practices that are not only unfair or deceptive, but also abusive.
- **GSE-040623:** FHFA, Fannie, and Freddie yesterday updated the sometimes-controversial equitable-finance plans FHFA approved last year.
- **GSE-040323:** We have written from time to time about covered bonds.

- **REFORM219:** With Thursday's White House announcement, we know that the Administration will do its best to support Fed and FDIC efforts to color recent events as a failure of Republican-led rulemaking, not also one of agency supervisory acumen, speed, and even competence.

- **REFORM218:** Today's HFSC hearing on recent bank failures was more partisan than yesterday's Senate Banking session (see *Client Report* **REFORM217**).

- **REFORM217:** Today's Senate Banking hearing was extremely well-attended by Senators on both sides of the aisle clearly looking first to understand what precipitated recent bank failures, who is to blame, and what should be done next.

- **RESOLVE50:** As noted yesterday, the FDIC's recent rescues have had several unusual features with implications not only for future policy, but also for pending special assessments to replenish the DIF for the $22.5 billion estimated costs to the Deposit Insurance Fund.

- **RESCUE79:** Recent editorials and other media have often said that the FRB and/or FDIC have powers or taken actions that is not the factual case as we understand it.

- **GSIB21:** In this report, we assess the implications of recent events on two assumptions underlying current U.S. and global policy affecting GSIBs and those considered domestic SIBs: first, all are likely to be well insulated from illiquidity and/or insolvency and, when this is not the case, then orderly resolution without taxpayer bailout can be readily deployed.

- **LIQUIDITY33:** Among the most vexing issues in the wake of SVB's failure is the extent to which social media may have led to the first "viral run," a run akin to the meme-stock volatility that lead the SEC and others to fear a new form of "flash-crash" risk.

- **GSE-032023:** In this report, we build on FedFin's in-depth reports about recent bank failures to detail new risks for all of the innocent bystanders in the U.S. mortgage market along with a not so-innocent bystander: the Federal Home Loan Banks.

- **REFORM216:** In this report, we continue our policy postmortem of SVB/SBNY and, now, so much more.

- **DEPOSITINSURANCE118:** As promised in our first post-SVB impact assessment (see *Client Report* **RESOLVE49**), this report begins a series of analyses of specific policy issues.

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
© 2023. Federal Financial Analytics, Inc. All rights reserved.