FedFin Daily Briefing

Monday, July 3, 2023

UK Targets PE/Private-Credit Interconnections

Although U.S. regulators have begun to talk about inter-connections (see FSM Report **SYSTEMIC95**), the Bank of England's top official for international finance today laid out new U.K. policy to address them. Specifically, Nathanaël Benjamin addressed counterparty risk with particular attention to bank private-equity and private-credit exposures. Mr. Benjamin's concern is principally that, should the U.S. not pull off a soft landing, this sector could experience severe stress that could quickly migrate to asset management. Mr. Benjamin is also troubled by the scope of securities-financing transactions, especially with regard to repo-match books, fearing that sovereign-debt volatility akin to that experienced last year in the U.K. could stress the entire wholesale-finance system. Firms are thus told to prepare for "once-unimaginable" volatility as well as indirect counterparty exposures, liquidity shortfalls, and back-office challenges. The speech also notes concerns in certain structured-equity sectors and commodities, urging banks active in commodities hedging to be mindful of margining risk (also a top FSB concern not yet highlighted in the U.S.). To the extent the U.K. imposes new standards on foreign-bank branches – and his talk suggests it will – U.S. banks may face requirements with indirect impact on overall activities even if U.S. regulators do not expressly follow the BoE's lead.

IOSCO Sticks With SOFR

Acting on concerns often expressed by SEC Chairman Gensler, IOSCO today published its final assessment of USD LIBOR, judging two credit-sensitive alternatives problematic and blessing limited use of certain term SOFRs. The most immediate consequences of this will be to make the Fed still less likely to permit banks to use the limited credit-sensitive exemptions provided in its final alternative-benchmark rule (see FSM Report **LIBOR9**), with IOSCO emphasizing its point with specific reference to this option by urging only cautious use of these rates and suggesting that regulators (presumably outside the U.S.) review their permissibility. Term SOFR rates are as noted deemed less problematic, but IOSCO nonetheless urges more transparency as well as monitoring to ensure that underlying derivatives markets remain sufficiently liquid. This cautionary note is germane not only to the Fed rule, but also to the SOFR exceptions allowed by FHFA for Fannie, Freddie, and the Home Loan Banks. Administrators making use of alternative rates are also urged to ensure sufficient transparency for users and regulators.

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-063023:** In non-public remarks ahead of a presentation by FedFin managing partner Karen Petrou, Sen. Jack Reed (D-RI) laid out what he thinks banking agencies will do next, doubtless based on what they've told him that they'll do next.
- **COMPENSATION37:** The Senate Banking Committee has overwhelmingly approved bipartisan legislation to reform executive compensation following larger insured-depository institution (IDI) failures, with parent-company executive compensation also at risk in some circumstances.
- **ESG4:** Late Friday, GOP HFSC Members issued a withering report criticizing the Biden Administration

for using financial regulators to do its political bidding on ESG objectives that it believes "contort" financial regulators into political instrumentalities that put retail investors at risk.

- **GSE-062223:** A *Bloomberg* article tells a fascinating tale of high-flying personal real-estate investment and other alleged acts of self-dealing at the expense of the seemingly-hapless Federal Reserve Bank of San Francisco.
- **FEDERALRESERVE74:** Chairman Powell's HFSC appearance today led to unusually substantive discussion of pending financial-policy actions.
- **GSE-061523:** The FHFA's report to Congress this year was eagerly awaited to see if it shed any insight into what FHFA might do after its listening sessions and Sandra Thompson's promise to do something sometime soon about the Home Loan Banks.
- **CONSUMER51:** With Rep. Andy Barr (R-KY) leading the attack with an accusation of CFPB "McCarthyism," today's HFSC hearing with Director Chopra tracked much in yesterday's Senate Banking session.
- **REFORM227:** Treasury Secretary Yellen was pressed at today's HFSC hearing to comment on pending bank capital standards, the scope of FDIC coverage, and failed-bank resolutions.
- **CONSUMER50:** Reflecting Acting Comptroller Hsu's focus on consumer protection, fairness, and inclusion, the OCC is seeking views on what could become an annual survey of what consumers and especially bank customers think of their bank.
- **VENDOR10:** After frequently citing third-party relationships and outsourcing as worrisome risk, the banking agencies have now finalized guidance first proposed in 2021 to govern them.
- **GSE-060823:** As we will detail in a forthcoming in-depth report, the banking agencies' new "guidance" on third-party vendors essentially brings all nonbank counterparties with whom banking organizations deal under the agencies' enforcement thumb.
- **COMPENSATION36:** Sen. Warren (D-MA) has introduced a revised version of legislation to ensure that both the FDIC and other federal banking agencies can demand that executives and others governing failed banks refund direct and indirect compensation to the federal government.

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