FedFin Daily Briefing

Wednesday, July 5, 2023

Basel Targets Credit-Risk Models, Assumptions

The Basel Committee yesterday issued a newsletter highlighting recent internal credit-risk discussions as well as supervisory action and remaining concerns in this area. Although few specifics are provided, national supervisors' main priorities include governance controls around model risk management, capturing economic uncertainty, and identifying credit deterioration in vulnerable sectors and borrowers. The newsletter also notes that supervisors have issued guidance on IRB models and taken remedial action for some banks with under-calibrated probability-of-default models—issues not yet addressed in the U.S. that may come in concert with the pending end-game capital rules. The Committee also warns that some credit-risk assumptions have become disconnected from real risk due to pandemic-era government support, promising continued monitoring of emerging risks as well as bank modelling practices.

FSB/IOSCO Focus on OEF Redemption Risk

Departing from the SEC's swing-pricing approach to open-end fund risk, global regulators today proposed a new exit-fee construct. If the U.S. chooses to advance this – as it well may given the SEC's role on these bodies – it will almost surely require a new SEC proposal, significantly delaying U.S. action in this controversial area. The FSB's consultation proposes three OEF "buckets" intended to reduce liquidity mismatch risk by mandating new "anti-dilutive" liquidity-risk mitigation tools that not only create new daily-redemption obstacles as OEF assets become increasingly illiquid, but also impose new fees stipulated in the accompanying the IOSCO consultation. Swing-pricing is one possible anti-dilutive option under the IOSCO approach, but both consultations are more focused on direct fees to limit first-mover advantage in both benign and stressed markets. The proposals also include significant new governance and disclosure requirements. Although OEFs do not have the cash-equivalent status usually accorded MMFs, these changes would nonetheless make them less satisfactory alternatives to bank deposits for those retail investors hoping for daily liquidity. Comments on both consultations are due by September 4.

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-070523:** As an in-depth FedFin analysis today addresses (see FSM Report **REALESTATE25**), the banking agencies and NCUA late last week issued far-reaching guidance encouraging loan accommodations and even forbearance for troubled commercial real estate (CRE) projects, including multifamily obligations.

- **REALESTATE25:** The banking agencies and NCUA have agreed on a final policy statement providing guidance for how financial institutions are to handle troubled commercial real estate loans, giving banks considerable latitude to forbear when borrowers are unable to meet their obligations but are deemed to be able to pay at least some of it over time.

- **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.

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