FedFin Daily Briefing

Tuesday, August 8, 2023

IMF Staff Presents New CCyB Trigger

A new IMF paper weighs into an important question inherent in the new construct of U.S. regulatory capital: how to set the counter-cyclical capital buffer (CCyB) to anticipate financial stress. As noted in a recent Karen Petrou memo, the Basel CCyB (see FSM Report **CAPITAL173**) is linked to a ratio of credit growth to GDP; the Fed's CCyB (see FSM Report **CAPITAL213**) gives the Fed unlimited discretion to sound the capital alarm or release the buffer. Using data from 108 economies from 1995 to 2017, the IMF's staff paper finds that the combination of rapid asset-price growth and low asset-price volatility best predicts mass-market stress within the next three years. The rationale behind the data is that the pricing and volatility indicators are effective mispricing identifiers, with widespread mispricing a trigger to systemic risk due to phenomena such as the "Minsky moment" of sudden price recognition sparking severe credit and liquidity market disruptions.

GAO Asks Banking Agencies To Focus On Blockchain, Alternative Data, PCA

The GAO today issued its annual policy recommendations to the federal banking agencies and the SEC. All of the agencies are asked to coordinate policy on blockchain to better address risks; the agencies neither agreed nor disagreed, each flagging routine interagency engagement. GAO maintains that coordination efforts have failed to address cryptoasset risks in a timely manner. Recommendations to the Fed, OCC, and FDIC urge coordination of policy on alternative data and clarifying how banks must handle third-party relationships, a somewhat puzzling recommendation in light of recent rulemaking (see FSM Report **VENDOR10**). The banking agencies agreed with the recommendation. The banking agencies are also pressed to revisit their prompt corrective action framework and implement noncapital triggers, a finding GAO reiterated following March bank failures (see *Client Report* **REFORM223**) that then gained considerable traction with Republican critics of the Fed's response (see FSM Report **FEDERALRESERVE74**); the Fed did not respond to this recommendation. In addition, the FRB is asked to reduce the uncertainty surrounding post-stress capital estimates during capital analysis as well as its tolerance levels for key risks identified through sensitivity testing. The Fed agreed with these recommendations.

Warren Presses Goldman Hard on SVB Conflicts

Not letting one letter to Goldman Sachs suffice when it comes to SVB, Sen. Warren (D-MA) yesterday sent another letter to the bank taking serious issue with its response, particularly regarding the steps it took to avoid conflicts of interest. She thus reiterates her prior questions, now also requesting a breakdown of Goldman's profits, the nature of the "arms-length" negotiations, any similar relationships with other banks, and whether Goldman has initiated policy changes since SVB's failure. Responses are requested by August 21.

OCC Targets Fintech Partnerships

Continuing its fintech-partnership crackdown, the OCC today clarified that its legal lending-limit standards apply to purchased loans and particularly to those purchased from nonbanks. The new guidance applies to all national banks, community institutions included. The statement says that aggregate loans from a loan seller must be computed to assess loan-limit compliance. Loans are attributable to the seller if the bank has direct or indirect recourse to the seller, with indirect recourse evident even without a contractual obligation if the bank's business conduct with the seller has created recourse expectations.

IMF Reiterates Need for U.S. Mid-sized Bank Regs, Better Contingency Funding

Building on its prior assessment of U.S. performance in its most recent financial-stability review, the IMF today cautioned the U.S. to focus more on smaller-bank vulnerabilities and closely monitor asset markets, bank earnings, and run risk interlinkages. The U.S. and other jurisdictions are also advised to continue to address systemic liquidity risks and spillover effects. The post also reiterates prior concerns over what the Fund considered "relaxed" U.S. stress testing for mid-sized banks, pointing in particular to SVB. Although the recent inter-agency statement on contingent funding and discount-window access is not mentioned, staff note that central-bank liquidity did not work well enough to prevent SVB's failure. Flagging the U.K., the post also notes pension-fun run risk resulting from margin calls.

Fed Sets New Course on Novel Activities, Tokenization

Eschewing formal action that might have required publication for comment, the FRB this afternoon released "information" on how it supervises "novel" activities at BHCs and state member banks such as complex fintech partnerships, DLT utilization, and cryptoassets along with a new non-objection process for state member banks related to stablecoins and other dollar tokens. The novel-activity guidance was promised in Vice Chair Barr's SVB analysis (see *Client Report* **CAPITAL228**), but the new policy appears aimed more at what toppled Signature and Silvergate than SVB (where venture-capital related customers and exposures were problematic). We will shortly provide clients with an in-depth analysis of both the novel information and its companion statement on crypto activities.

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-080823**: Our most recent analysis of the inter-agency capital proposal focuses on significant changes to the rules for securitization and credit-risk transfer positions.
- **CAPITAL232**: Based on our analysis of the inter-agency capital proposal's framework and its credit-risk provisions, FedFin turns now to the proposed approach to equities as well as to that for securitization exposures (i.e., those that are tranched rather than simple secondary-market issuances of packages of loans or other assets backed as needed by a single credit enhancement).
- **CAPITAL231**: In this report, we proceed from our assessment of the proposed regulatory capital framework to an analysis of the rules governing credit risk.
- **GSE-080323**: As we plow on with our in-depth analysis of the new capital proposal, we will continue to advise of key provisions in the massive rewrite with important implications for residential-mortgage finance.

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- **CAPITAL230:** In this in-depth report, we begin our analysis of the 1089-page capital proposal released by the U.S. banking agencies not only to make U.S. standards more consistent with Basel's 2017 "end-game" rules, but also to correct failings in the current capital framework the agencies believed were laid bare by recent bank failures.

- **GSE-072823:** We've much more to do to determine the strategic and policy impact of the new credit-, market-, and operational-risk capital rules singly and collectively – a complex task given the 1,087-page rulemaking made harder by some extremely-arcane language that may either mask what the agencies mean or differ from what they meant to mean.

- **CAPITAL229:** As promised, we plan in-depth coverage of the Fed and FDIC meetings tomorrow as well as of the capital rewrites they are set to propose no matter all the warning shots from Congressional Republicans.

- **MERGER12:** Building on a request for comment, the Department of Justice (DOJ) and Federal Trade Commission (FTC) have now proposed specific revisions to U.S. merger policy that significantly redirect the manner in which M&A transactions – even if only for minority positions – will be considered.

- **DEPOSITINSURANCE121:** In the wake of today's Senate Banking deposit-insurance reform hearing, it seems certain that there will be no legislation in the near term and most likely in this Congress to increase FDIC-insurance thresholds.

- **CLIMATE16:** As anticipated, Republicans continued their campaign against ESG at today's HFSC Financial Institution Subcommittee hearing on climate risks, reiterating arguments that a regulatory focus on climate risk signals financial institutions to cease lending to carbon intensive industries.

- **MMF20:** The SEC has significantly revised its proposed MMF-reform standards, eliminating a controversial swing-pricing approach to reduce first-mover advantage in favor of new redemption fees at institutional prime and tax-exempt funds.

- **GSE-071823:** Reuters is reporting today and other sources are echoing three regulatory sources saying that the impending capital rewrite will propose risk weighted assessments (RWAs) between 40 and 90%, up from the minimum 20 and 70% Basel standards.

- **GSE-071123:** As we detailed yesterday, FRB Vice Chair Barr laid out what he called a holistic view of bank capital standards that encompasses end-game rules, stress testing, post-SVB lessons, GSIB restrictions, and resolvability.

- **CAPITAL228:** FRB Vice Chairman Barr's speech today outlines near-term U.S. regulatory-capital policy, confirming our earlier assessment that a sweeping proposal will soon be released.

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