FedFin Daily Briefing

Wednesday, August 30, 2023

FRB Chicago Study Finds Nonbanks Act as Global Shock Absorbers

A new empirical FRB Chicago study finds that nonbanks act as global shock absorbers during times of stress because tightening US monetary policy is associated with increased nonbank syndicated dollar lending compared to banks. This of course frustrates monetary-policy transmission in the U.S., but the paper focuses on EMEs where the principal risk is macroeconomic and financial shock. A 25-basis point fed funds increase aligns with a five percent relative increase in nonbank lending, a result that holds for investment banks and finance companies, domestic and foreign lenders, and domestic and cross-border lending. The study asserts that this substitution may be due to higher risk tolerance, as the increase is larger for nonbanks lending to borrowers from emerging markets and to borrowers paying higher yields. However, total borrower-level credit still falls in times of stress as the increase in nonbank credit is less than the drop in bank lending. The FRB-Chicago staff highlight the financial stability trade-off of better access to credit during times of stress versus more fragile nonbanks and call for further study on the role and design of public interventions in credit markets where both banks and nonbanks are present.

Comment Period Reopened on Controversial Custody Proposal

The SEC today reopened the comment period on its controversial investment-advisor asset custody NPR. As noted (see FSM Report **CUSTODY5**), this thorough rewrite would redefine qualified custodians to exclude most crypto firms, as well as foreign firms and other entities the Commission does not believe ensures sufficient safeguards. Assets covered by the qualified-custodian requirement would be expanded from funds and securities to "client assets" covering a wide range of current and prospective assets such as collateral, commodities, and real estate. Congressional Republicans have sent letters criticizing the proposal for going beyond the SEC's authority and placing onerous requirements on digital assets. Comments are now due by October 30.

FSB Seeks Comment On Securitization Reforms

The FSB today announced that it will evaluate the impact of G20 securitization reforms (see FSM Report **ABS37**) on its financial-stability objectives as well as on securitization markets. The evaluation will focus on regulatory capital regulation governing securitization exposures and RMBS and CDO/CLO market segments, although the FSB will also consider including other segments. Analytical options include review of ex-ante impact or ex-post evaluation studies, qualitative analysis looking at matters such as securitization markets under stress, and quantitative analysis of the growth and performance of relevant securitization markets. The FSB will publish preliminary findings in early 2024 and expects to finalize a report by mid-2024; initial feedback is requested by September 22.

Warren Blasts Powell, Alleging Capital-Reg Delay, Concessions

Expanding on her longstanding criticism of Chair Powell, Sen. Warren (D-MA) sent him a letter today chastising him for what she views as undue deference to big-bank lobbying and demanding that he press for the rapid completion of tough new capital rules. Citing Mr. Powell's statement at the board meeting approving the rules, Sen. Warren says the chair is not honoring his commitment to back Vice Chair Barr's post-SVB recommendations. She also alleges that the Fed has already bowed to big-bank pressure by implementing a longer than usual comment period of 120 days. No deadline is given for a response.

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.

- **GSIB22**: As anticipated in the wake of recent bank failures, the FRB has proposed a significant revision to the current rules calculating systemic-risk scores that lead to GSIB designation.
- **CAPITAL234**: With this report, we conclude our assessment of the regulatory-capital proposal with analysis of what the sum total of the credit (see FSM Report **CAPITAL231**), operational (see FSM Report **OPSRISK22**), and market (see FSM Report **CAPITAL233**) rules could do in the real world of banks, nonbanks, foreign banks, and complex market interconnections.
- **CAPITAL233**: In this analysis, we turn to one of the costliest aspects of the proposed rewrite of U.S. regulatory-capital standards: the market-risk framework.
- **GSE-081423**: As Karen Petrou's memo today suggests, there are many reasons the new operational-risk framework proposed in the capital rewrite will not only be costly for covered banks, but also counterproductive for financial resilience.
- **CRYPTO45**: In conjunction with issuing a new supervisory policy for "novel" activities, the FRB has instituted a new process requiring non-objection letters before state member banks proceed with stablecoin or dollar-tokenization activities.
- **GSE-081023**: FHFA today released the results of the ninth stress test it's run on Fannie and Freddie since Dodd-Frank demanded this in 2010.
- **OPSRISK22**: Noting that operational risk is present at all banks due to most activities, the U.S. regulatory-capital rewrite would end the current approach to operational risk-based capital (ORBC).
- **FINTECH32**: FRB Vice Chairman Barr's assessment of SVB's failure included a commitment to pay additional supervisory attention to "novel" activities.
- **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.
- **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.

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