FedFin Daily Briefing

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FRB FAQs Open a Small, But Significant Capital Window

In what Reuters takes as a sign of hope that the end-game rules may not be as crushing as banks fear, the FRB has issued a new FAQ related to credit-linked notes and SPVs. The FAQ clearly allows credit-risk mitigation (CRM) treatment for collateral due to the note's cash proceeds pledged by the SPV issuing the credit-linked note backing assets on the bank or BHC's balance sheet if the collateral meets CRM and operational requirements. Although directly-issued credit-linked notes are not clearly synthetic securitizations, the new FAQs also allow Fed-regulated entities to petition the Fed for capital relief if the actual structure can be demonstrated to be comparable to a synthetic securitization and meets relevant operational requirements. The current OCC and FDIC capital standards do not directly address credit-linked notes, but the agencies may be persuaded by the FAQs at least via petition to provide relief to certain collateralized structures. However, it should be noted that so technical an FAQ was likely not cleared by the other agencies or Vice Chair Barr, with the FDIC always most hesitant to accept liberalizations of risk-based capital standards for IDI balance-sheets the agency could inherit in a resolution. That said, these notes are already addressed in at least one GSIB's resolution plan. If other agencies concur with the Fed, then this could be a significant boost to credit-linked notes, now a major source of CRM to EU banks, bypassing restrictions on covered notes or other forms of structured CRM in the U.S. The pending capital standards (see FSM Report **CAPITAL231**) do not address credit-linked notes but clarify synthetic securitization treatment in ways that do not appear to override the FAQ.

Bowman Turns to Specific Supervisory Reforms

In remarks today, FRB Governor Bowman expanded on her prior comments about Fed supervisory lapses, but made it clear that she also opposes a "heavy-handed" supervisory approach that relies primarily on call report data, instead calling for a new approach to CAMELS and regular engagement with financial institutions to express areas of concern or to better understand a bank's strategic direction. She notes that, while financial results are key, supervisors need to use all available tools. Gov. Bowman also again called for third-party independent reviews the Fed's actions in recent failures, commenting the Barr report (see *Client Report* **REFORM221**) and new OIG one on SVB on grounds that they also noted "limited scope."

Fed OIG re Silvergate: Far More Scathing re Supervision, Need for New Guidance

The OIG report today from the Fed regarding supervisory lapses at Silvergate is considerably less expansive than the prior report on SVB because the parent company remains open despite the IDI's voluntary liquidation and relevant data are thus deemed confidential. The OIG attributes Silvergate's failure to reliance principally on uninsured deposits and its crypto-asset concentrations, pressing for the type of novel-activity standards the Board has since adopted (see FSM Report **FINTECH32**). As with SVB, the OIG also points to exponential growth that supervisors failed to heed, with the report also referencing "nepotism" on the bank's board likely now a subject of enforcement activities contributing to the OIG's decision not to release its full analysis. The text released also seems considerably more critical of the San Francisco Fed's supervisory acumen, but the OIG now expressly also states that Board statements should deal not only with novel activities, but also with uninsured-deposits for other volatile-funding concentration and with the risk of rapid growth. The public portion of the report provides no indication of whether the Fed agrees with these recommendations.

Barr Presses Emergency-Window Readiness

FRB Vice Chair Barr's comments today on monetary policy and financial stability provide a detailed rationale for addressing the linkages between these two arms of the Fed's mandate without any specific steps for doing so. However, Mr. Barr took the opportunity of this speech to emphasize the need for banks quickly to ensure deposit-window readiness as required in recent interagency guidance. He does not reference the pending FRB/FDIC resolution standards (see FSM Report **LIVINGWILL23**) that also do the same via express rulemaking.

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-100223:** As we noted earlier today, the FRB has issued a seemingly technical FAQ liberalizing the treatment of certain credit-linked notes.
- **GSE-092523:** In her Congressional testimony last week, FedFin managing partner Karen Petrou focused on the unintended consequences wrought by new banking proposal based on their cumulative impact.
- **GSE-092023:** Or maybe it is, but not everyone has heard.
- **LIVINGWILL23:** Although a pending FDIC/FRB proposal imposes a raft of new requirements for resolution plans from IDIs with over $100 billion in assets, the FDIC has also issued a freestanding proposal doing the same, also setting information-filing standards for IDIs below $100 billion but above $50 billion.
- **CAPITAL235:** With HFSC Chairman McHenry (R-NC) leading the way, GOP Members of the panel's Financial Institutions Subcommittee today blasted the banking agencies' end-game proposal (see *Client Report* **CAPITAL234**).
- **LIVINGWILL22:** In conjunction with proposing a new long-term debt (LTD) requirement for categories II, III, and IV banks, the Fed and FDIC are pursuing other ways to enhance resolvability.
- **TLAC9:** Building on an advance notice of proposed rulemaking, the banking agencies have issued several proposals to enhance the resolvability of large banking organizations not covered by stringent GSIB standards.

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