FedFin Daily Briefing

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BIS: CCP Collateral Holdings Pose Systemic Risk

A new BIS study looks at the risk that the transformation of OTC markets to centrally-cleared ones has in turn transformed markets based in part on know-your-counterparty into those dependent principally on collateral backing margin positions – an inherently more fragile market structure. Using public CCP data, the BIS paper finds that CCPs in mid-2023 held $1.3 trillion in collateral consisting largely of government bonds and cash equivalents, with shifts in collateral composition leading to fixed-income market price and liquidity disruptions. Large collateral holdings of course protect CCPs from counterparty risk, but the paper finds that their holdings – about ten percent of like-kind GSIB positions – transfers risk to market participants whether this be in volatile reverse-repo markets or sudden initial-margin demands that cause the kind of fire sales evident in the 2020 dash for cash. These findings have been highlighted by the FSB and others in their post-2020 work on NBFIs (see *Client Report* **NBFI2**). However, the BIS here adds a new risk consideration: still worse market disruptions because government bonds are collateral not only for CCP transactions, but also for underlying government-bond pricing – a new form of wrong-way risk with significant systemic impact. This is particularly problematic in emerging markets, but the paper points to the U.K. "gilt" crisis last year to show how small problems can quickly morph into global systemic risk. As the BIS paper notes, the FSB's NBFI work has identified CCP margining as a problem, but little has been done by global standard-setters or those in the U.S. and U.K. – where CCP risk is concentrated – to address it.

White House Presses FHLB Affordable-Housing Action

In remarks today, National Economic Advisor Lael Brainard not only highlighted the Biden Administration's actions to address housing affordability, but also mentioned plans for new financing programs. Notably, these would include greater FHLB affordable-housing contributions. This brings FHFA's FHLB-reform plans under the White House's ambit, adding greater force to the agency's plans to press greater AHP contributions and community focus within the boundaries of current law. Concrete proposals from the FHFA are thus likely early in the new year to ensure they feature in campaign-focused advocacy. Ms. Brainard's comments also say more generally that the Administration will reduce home ownership costs. It remains to be seen if this entails renewed interest in tackling title insurance or other GSE, FHA, or VA fees or programs.

Ambitious CFPB Regulatory Plans Come Into View

The CFPB's fall 2023 regulatory agenda provides status updates for several significant rulemaking items. These include an FCRA rulemaking listed in the "pre-rule" stage as of December 2023 as well as overdraft and NSF rulemakings already categorized for the "proposed rule stage"; NPRs for both items are set for release this month. Along with the other banking agencies, the Bureau next June is also set to propose a rule required by the Financial Stability Act that would establish data standards for collections of information reported to each agency by financial entities under their jurisdiction. The CFPB is also set to issue an NPR for mortgage servicing next March. Other rulemakings in the proposal stage include the Bureau's personal financial data rights rulemaking (see FSM Report **DATA4**) and supervision of large nonbank payment providers (see FSM Report **PAYMENT27**). Rulemakings in the final rule stage include those for AVMs, the Bureau's nonbank registry (see FSM Report **CONSUMER47**), the form contract registry (see FSM Report **CONSUMER48**), and credit card late fees (see FSM Report **CREDITCARD36**).

Basel to Set IRR, Window-Dressing, Crypto Standards

The Basel Committee's year-end meeting advanced plans to address interest-rate risk (IRR) with a concrete agreement to issue a new consultation later this month updating current global IRR standards (see FSM Report **IRR7**). The U.S. is likely to move on this perhaps as soon as the consultation is released given FRB Vice Chair Barr's statements highlighting IRR as a near-term target. Basel also plans a proposal early next year to toughen standards (see FSM Report **GSIB13**) now only discouraging GSIB window dressing, quarter- and year-end actions designed to adjust regulatory ratios found to have potential systemic impact. Plans are also afoot to revise the 2022 crypto standards (see FSM Report **CRYPTO37**) even though many nations such as the U.S. have yet to act on the old ones. Recognizing this, Basel will also issue a technical paper on crypto standards later this month. Basel emphasizes the need for implementing its crypto standards by pointing to new work on bank custody services in the cryptoasset arena it finds poses new forms of operational risk; these may also be addressed in new standards at some point down the road.

BIS Points to MMF Risk When Rates Rise

Another new BIS paper concludes that the record size of MMFs poses significant threat to dollar-funding market stability. U.S. MMFs now have $6.1 trillion in dollars within AUM, with the remaining $3.9 trillion outside the U.S. also held largely in dollars. The BIS also finds that MMFs principally lend to government and banks – not other sectors – when rates rise, with U.S. AUM increasing 34 cents for every dollar decline in bank deposits. This leaves a large gap in financial intermediation given the finding that MMFs do not – as often assumed – invest in other NBFIs or private-sector obligations to any significant extent when rates rise. However, large banks with access to MMFs are best able to counter sudden deposit flights such as those evident during the mid-March failures due to MMF funding that at the least protects their liquidity.

OCC Warns Banks of AI Risk, Possible Supervisory Action

Reflecting growing Congressional, regulatory, and industry concerns over AI, today's OCC semiannual risk assessment for federal banks states that national banks should be mindful of AI risks as these fall under current supervisory procedures. As a result, it seems likely that examiners will look at exposures related to the AI risks the agency highlights here – i.e., explainability, reliance on large volumes of data, bias, privacy, third-party exposures, cybersecurity, and consumer-protection risk. The report also notes possible AI financial-services benefits such as cost reductions, efficiency, improved products and performance, strengthened risk management and controls, and financial inclusion. In addition, the OCC report now highlights deposit-market issues stemming from competition from higher-yielding choices that reduce market liquidity. Although it raises concerns about declining corporate profitability, it also states that the federal banking system remains sound and declares that Mid-March's acute financial stability risks have abated. The report reflects data as of June 30.

Senate GOP Goes for Gruenberg's Jugular

Despite efforts by the FDIC to reassure critics about its independent investigation, Senate Banking Republicans today fired off a ferocious letter demanding that FDIC Chair Gruenberg immediately resign and, even if he were to do so (which we doubt he will), answer well over a dozen prosecutorial questions. Many of these demand only yes-or-no answers, posing questions about matters such as whether Mr. Gruenberg ever destroyed agency property in a rage, berated employees, defended those who harassed or abused employees, or otherwise engaged in or tolerated workplace misconduct. The letter also encourages whistleblower FDIC staff to contact Sen. Scott's office, with all of this surely an effort to force actions to light that the senators believe will force Mr. Gruenberg out and leave the agency in the hands of its Republican Vice Chair, Travis Hill. The extent to which this succeeds given strong Democratic support for Mr. Gruenberg will depend on whether any of the specifics implied in the letter's questions are in fact as pernicious as its phrasing implies.

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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

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- **GSIB23**: The agencies' capital proposal (see FSM Report **CAPITAL230**) unsurprisingly dominated discussion at today's Senate Banking hearing with big bank CEOs.

- **FINTECH33**: At today's HFSC Digital Assets Subcommittee hearing on banking agency financial innovation, Republicans raised concerns about the Fed's novel activities guidance (see FSM Report **FINTECH32**), interagency guidance on third-party risk management (see FSM Report **VENDOR10**), and the SEC's predictive data analytics proposal.

- **CONSUMER54**: Today's Senate Banking hearing with Director Chopra was even more cordial than yesterday's HFSC session (see *Client Report* **CONSUMER53**) even though Republicans continued to criticize the Bureau's recent rulemakings.

- **GSE-113023**: A new FRB-NY study confirms that 83% of loans from 2000-2022 went to first-time homebuyers, compared to 56% for the GSEs and 57% for private lenders.

- **CONSUMER53**: In sharp contrast to most recent HFSC hearings with CFPB Director Chopra, today's session was relatively calm.

- **GSE-112723**: The most significant thing in FHFA's final capital rule is not what is to be done, but what FHFA left out: ending the GSEs' advanced-approach requirement.

- **DEPOSITINSURANCE122**: As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic, the FDIC has finalized its proposed approach to imposing a systemic assessment to reimburse the Deposit Insurance Fund (DIF) for the resolution costs related to uninsured deposits following a systemic designation.

- **GSE-111623**: As our reports on the Senate and House hearings with bank regulators made clear, our prediction that the agencies would compromise on mortgage risk-based capital requirements will prove itself in the final standards.

- **REFORM230**: Following yesterday's Senate Banking hearing (see *Client Report* **REFORM229**), today's HFSC session with top bank regulators again highlighted growing bipartisan consternation over the unintended consequences of the agencies' capital proposal (see FSM Report **CAPITAL230**).

- **PAYMENT27**: Building on its director's longstanding focus on fintech and tech-platform companies, the CFPB has proposed to extend its supervisory reach to nonbank providers of general-use digital payments services.

- **REFORM229**: Today's Senate Banking hearing with top bank regulators showcased broad bipartisan concern over the interagency capital proposal (see FSM Report **CAPITAL230**).

- **SIFI37**: In concert with finalizing a new systemic-risk methodology, the Financial Stability Oversight Council issued guidance that significantly rewrites the manner in which nonbanks are designated as systemically important financial institutions (SIFIs), largely retaining its initial proposal.

- **SYSTEMIC98**: Rejecting the Trump Administration's hands-off approach to designating systemically-important nonbank financial institutions or activities and practices, the Biden Administration's FSOC has

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finalized its bifurcated proposals to designate systemic entities and another laying out an analytical approach to identifying systemic risk that would then guide firm and activity designation as well as Council staff coordination with primary federal regulators.

- **GSE-110823:** Although FHFA calls its FHLB report a centenary event ahead of the System's 2032 birthday, the agency clearly plans structural substantive reform well before that milestone.

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