FedFin Daily Briefing

Tuesday, December 12, 2023

IMF Calls for Enhanced Climate-Risk Analyses, Stress-Testing

Calling for implementation of the Basel Committee's climate-related financial risk principles (see FSM Report **CLIMATE14**), the IMF's Monetary and Capital Markets Department Director, Tobias Adrian, today pressed central banks to enhance their climate risk analyses and adapt stress-testing frameworks to better reflect climate-financial risk transmission and amplification channels. Praising recent international disclosure and data initiatives, he also calls on central banks to strengthen climate-related financial disclosures, close data gaps, and incorporate climate risk reporting into supervision. In addition, supervisors are encouraged to integrate physical and transition risks into risk assessments. He also notes that blended finance and securitization instruments should be part of the policy mix to broaden private-sector investment. Nothing in the talk specifically references the U.S., but new inter-agency climate-risk standards (see FSM Report **CLIMATE17**) reflect this global perspective even if it is not also that of many in the industry or on the Hill.

Agencies Come Under Still More Workplace-Practice Scrutiny, Political Pressure

As we noted last week, House Republicans are now using ongoing assertions of FDIC workplace dysfunction to attack the OCC. Yesterday, Senators put the incident to use in a letter to the Federal Reserve, OCC, and – again – the FDIC. Signed by Sens. Hagerty (R-TN) and Sinema (I-AZ), the letter targets NDA agreements accompanying employee settlements and demands to know if any of the agencies use this tactic. They state that this practice undermines essential workplace controls, allows official misconduct to continue at threat also to regulatory and supervisory integrity, and costs taxpayers. The issue is likely to be one on which Democrats stand with Republicans if the Fed or OCC admits or is found to have used NDA agreements related to sexual harassment or other disputes. Responses to a series of questions are due by December 22.

HFSC Subcomm Considers Sanctions Enforcement

Today's HFSC National Security Subcommittee hearing focused primarily on critiques of US energy sanctions enforcement related to Russia, Iran, and Venezuela. Chairman Luetkemeyer (R-MO) attacked the Biden Administration's softening of sanctions, stating that US policy should maximize domestic and allied hydrocarbon production and heavily sanction bad actors. Ranking Member Beatty (D-OH) criticized Republicans for attempting to cut funding from government agencies responsible for sanction enforcement. Full committee Ranking Member Waters (D-CA) echoed Rep. Beatty's critiques and called on Congress to pass President Biden's supplemental package for Ukraine. In testimony, all five witnesses mentioned the need for greater sanction enforcement, with Marshall Billingslea of the Hudson Institute claiming that poor sanction enforcement against Iran has allowed that nation to increase oil production under President Biden. Witnesses also called for actions such as greater multi-lateral support and international surveillance, with Adam Smith of Gibson, Dunn, and Crutcher stating the need for the G7 Enforcement-Coordination Mechanism.

House Select Committee Calls on Fed to Stress Test China Risk

The House Select Committee on the Strategic Competition between the United States and the Chinese Communist Party today released a bipartisan report urging Congress to direct the Fed to stress-test U.S. banks for their ability to withstand Chinese market risk, produce classified reports on these assessments, and consider the financial market impact of potential sanctions on Chinese financial firms. The report also finds that U.S. investment in China poses systemic financial stability risks and calls on Congress to direct FSOC to submit regular reports to Congress on the aggregate quantities of all American-held Chinese-associated assets. In addition, the report calls on Congress to pass legislation prohibiting investment in

Chinese companies cited on U.S. sanctions and red-flag lists, require the U.S. government to impose sanctions on China should it invade Taiwan, and authorize Treasury to sanction Chinese companies with direct ties to the nation's military. The call for stress-testing legislation echoes that from Democrats (see FSM Report **GREEN10**) using stress-testing to advance priorities deemed to pose systemic risk even if neither the Fed nor FSOC yet sees it that way. As evident in the bipartisan nature of the Select Committee's report, many of its recommendations could advance next year in both the House and Senate, especially if China continues to threaten key U.S. national-security, military, and economic interests.

Basel Proposes Modest Fix to IRR Standards, Post-SVB Revisions Await

As anticipated, the Basel Committee today released a consultation revising global interest-rate risk (IRR), standards updating current banking-book standards (see FSM Report **IRR7**) to toughen the IRR-shock calibration. However, these changes address only now-past conditions when interest rates were at or near zero, not rates prevailing at the time of recent IRR-related stress and bank failures. The Committee appears to acknowledge this, calling the revisions a "targeted" change unrelated to broader and continuing analytical work following the mid-March failures. We will review the proposal to ascertain its broader strategic impact; comments are due by March 28.

McKernan Extends Capital Olive Branch

FDIC Director McKernan today offered an end-game compromise that might actually lead to final rules in 2024 that defer some of the proposal's most problematic aspects. Much of what Mr. McKernan recommends is relatively technical, although it would still differentiate the U.S. rules from Basel's standards. However, the promise to review outstanding items combined with action on other key provisions will surely keep the U.S. seat at Basel's table. Reflecting his audience, Mr. McKernan's compromise focuses principally on revisions to the market-risk proposal (see FSM Report **CAPITAL233**), agreeing with the over-arching goals of the NPR in areas such as reducing models reliance, eliminating the VaR measure, and reducing banking/trading-book arbitrage. Mr. McKernan instead focuses on the PLA test and approach to non-modellable risk factors as issues to postpone. He also urges two rounds on key aspects of the operational- and credit-risk sections, suggesting delay on risk factor eligibility tests and for changes to the treatment of certain derivatives and re-calibration of the 10 percent credit conversion factor for unconditionally cancellable lines of credit (see FSM Report **CAPITAL231**). Despite this considerable olive branch, many other issues – e.g., the dual-track credit-risk standards – remain to be resolved, as do sweeping questions about the impact of the capital rule on its own and in concert with other proposals now and to come. Considerably more concessions would likely be needed on both sides to finalize the rules, but Mr. McKernan's offer is a significant start on serious negotiations.

House Advances Bipartisan Beneficial-Owner Reform

Presaging likely Senate action, the House today voted 420-1 to approve H.R. 5119, legislation from Rep. Zach Nunn (R-IA) revising the 2021 AML law (see FSM Report **AML133**). Key provisions would block reporting companies from omitting information deemed difficult to obtain, a change Rep. Nunn believes targets Chinese shell companies but is likely to govern many others. The bill also requires new companies to file beneficial-owner disclosures within ninety days of formation, but it eases requirements for existing U.S. businesses by a year while Treasury finalizes key regulations.

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.

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

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- **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.

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