FedFin Daily Briefing

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Basel Head Backs U.S. End-Game

In an *FT* interview today, the Basel Committee's chair, Pablo Hernández de Cos, unsurprisingly endorsed the U.S. end-game proposal, indirectly but firmly rebutting assertions that it is at variance with global norms. While the global standards do allow for internal models, Mr. de Cos reaffirmed that the final global framework (see FSM Report **CAPITAL221**) deems nations that use only its standardized approach in accord with global standards. He did not address U.S. industry concerns that gold-plated standards will adversely affect competitiveness vis-à-vis foreign banks. Although the end-game is supposed to be just that, Mr. de Cos also did not rule out yet another global rewrite should circumstances come to warrant one, a position ensuring the Basel Committee's longevity.

The Shape of Liquidity Rules to Come

Previewing the construct of what may soon be the anticipated inter-agency proposal addressing liquidity-risk lessons-learned, Acting Comptroller Hsu today argued that the liquidity coverage ratio's treatment of retail depositors (see FSM Report **LIQUIDITY17**) does not address likely depositor herding as they run for the exit. He thus recommends improved classification of higher-risk deposits to capture herding risk, applying an appropriate outflow rate to these funds. However, Mr. Hsu also says that it will take time to determine how best to differentiate operational and non-operational uninsured deposits, a factor we would think essential to ensure that new high-risk outflow rates capture funds at greatest risk. Building on recent inter-agency guidance on discount-window readiness, Mr. Hsu also reinforced the need for preparedness, but opposes calls to expressly include discount-window capacity in liquidity ratios in broad terms due to potential moral hazard. However, he does support allowing this when it comes to "ultra-short" – i.e., five-day – runs through a new, special liquidity standard. This standards' numerator would include discount-window capacity and the denominator would encompass the speed and severity of uninsured-deposit outflows. Tougher stress-testing is also in order. Looking ahead, the OCC is investigating evolving deposit characteristics, policy measures to limit contagion risk arising from what Mr. Hsu called "guilt by association," and third-party and fraud risk management in the context of increased tokenization.

Rounds, Sinema Press for SIFI-Designation Rollback

Senate Banking Committee Member Rounds (R-SD) alongside Sen. Sinema (I-AZ) introduced S.3601, legislation to codify 2019 standards (see FSM report **SIFI35**) adding significantly more obstacles to systemic designation compared to FSOC's new approach (see FSM report **SIFI36**). The bill would also require FSOC to consult with both the primary regulator and company on other ways to address financial stability threats and require FSOC and its member agencies to report on potential threats and crisis planning activities. The bill will not advance in the Senate.

Steele's Good-Bye Presses for More Tough Standards

In his last speech in office, Assistant Secretary for Financial Institutions Graham Steele today called for reassessment of the treatment of unrealized gains or losses not just under the capital rules, but also in the liquidity standards (where they are in fact to some degree now captured). He also recommends that new prudential standards address regulatory lags for fast growing large banks by reducing the phase-in time for stress testing and stress capital buffer requirements. Mr. Steele also calls for new liquidity calibration standards for large, regional, and midsize banks not only for uninsured deposits as Mr. Hsu did earlier today, but also for brokered deposits. He also urges regulators to consider whether their frameworks should provide comparable treatment for large regional banks with or without a holding company and presses vigorous enforcement and like-kind regulatory treatment for cryptoassets along with a wholesale rewrite of payment-system consumer protection. He also argues for an improved merger review process to better capture financial stability risks.

House Democrats Damn Capital Proposal With Faint Praise

In this report, we begin our assessment of Congressional end-game comment letters. These will have an outsize impact on what the agencies do, especially when Democrats do not endorse the broad scope of the proposals as is often the case. First, a letter signed by Financial Institutions Subcommittee Ranking Member Foster (D-IL) and 22 other House Democrats encourages the agencies to make public as much data and analysis behind the proposal as possible, also urging the agencies also to evaluate the proposal in a collaborative and transparent manner. The letter does support efforts to improve safety and soundness, but nonetheless urges agencies to consider consumer and business impact and the competitive balance between banks of varying sizes and international entities. The letter notes that the proposal no longer corresponds with EU and UK counterparts due to higher standards that could result in steeper capital increases and asks for as much communication and transparency as possible from the agencies to minimize adverse effects. Additionally, the letter reminds the agencies to consider bank consolidation, analyze “cliff effects” that may encourage banks to stay below certain key size thresholds, and states that the proposal should promote small and medium banks’ ability to compete with bigger counterparts.

The second letter was led by National Security Subcommittee Ranking Member Beatty (D-OH) and was signed by 58 House Democrats. It is generally supportive of the proposal but goes on to take issue with specific aspects of the Basel proposal such as mortgage risk weights and limited PMI consideration, and expresses concern regarding the impact on cost and access to banking services, mortgage affordability, and credit availability. Specifically, the letter targets the proposal’s 20% higher risk weight for mortgages compared to the International Basel Agreement as particularly punitive to high-LTV mortgages and especially problematic for LMI borrowers. The letter also notes that the proposal limits the consideration of PMI which it claims could give low down payment buyers fewer options and disincentivize high LTV mortgage providers. Additionally, these House Democrats note that the proposal could impact the real estate industry’s ability to access funds to build affordable housing and target the operational-risk analysis which is claimed to overstate risk compared to historical loss data, recommending a recalibration of the operational risk charge. The letter closes by stressing the importance of the agencies’ taking comments and new data into account and warns of potential unintended consequences including raising retirement costs, adverse impacts to capital markets, and potentially discouraging bank investment in CDFIs and MDIs.

Senate Letters Slam Capital Proposal's Tax-Equity Risk Weight Changes

Here, we turn to several Senate letters on the end-game proposal. First, Sen. Van Hollen (D-MD) alongside twelve Senate Democrats today warned that the proposal’s changes to tax-equity investment risk weights may have “chilling” consequences for clean energy investments. The letter takes issue with the proposal’s removal of the ten percent threshold for non-publicly traded equity which would bump risk weights from 100% to 400% for non-publicly-traded equity investments that are the primary source of capital for clean energy projects.

This letter echoes letters sent by Sen. Joe Manchin (D-WV) and Sens. Sinema (I-AZ) and Crapo (R-ID). Sen. Manchin took issue with the same ten percent threshold rule for tax-equity bonds, noting that it could harm American energy security and undo progress made in the Inflation Reduction Act. Sens. Sinema and Crapo also take issue with the same ten percent threshold, stating that the proposed higher risk weights will make it more expensive to build energy projects and affordable housing, shrinking tax equity investments in renewable energy projects by eighty to ninety percent.

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-011224**: A new staff paper from the Federal Reserve Bank of New York assesses the tender topic of bank mortgage lending to minority borrowers.
- **GSE-010924:** Based on recent dialogue with institutional investors and regulators, a new FRB-NY Teller Window article concludes that robust data collection, loan standardization, and higher volume could improve CDFI secondary market sales.
- **GSE-010824:** It's not news to observe that things that change at the GSEs then change a lot of other things.
- **INCLUSION3:** As required by law, the U.S. Treasury is working to set policy enhancing financial inclusion.
- **NBFI3:** The banking agencies have proposed significant changes to call-reporting data illuminating how banking organizations are inter-connected with nonbank financial intermediaries and to implement pending requirements for long-term debt (LTD) issuance.
- **DEPOSITINSURANCE123:** In the wake of increasing instances in which customers are confused and even misled about the extent to which fintech and cryptoasset holdings are insured deposits, the FDIC has finalized its proposal setting disclosure standards as well as modernizing IDI representations of their own FDIC-insured offerings in branches and through the fast-changing array of retail banking delivery channels.
- **GSE-010224:** Shortly before the new year, the banking agencies proposed new call-report requirements that would force banks with over $10 billion in assets to report new data on nonbank mortgage intermediaries and structured GSE-guaranteed positions.
- **AI4:** Bipartisan Senate legislation has been introduced to press FSOC to do more than highlight artificial intelligence (AI) as a potential threat to financial stability.
- **MERGER13:** Building on a request for comment and a formal draft, the Department of Justice (DOJ) and Federal Trade Commission (FTC) have finalized specific revisions to U.S. merger policy that significantly redesign the manner in which M&A transactions will be considered.
- **SANCTION21:** As promised, this report provides an in-depth assessment of President Biden's Friday executive order expanding anti-Russia sanctions via secondary ones on financial institutions that – knowingly or not – facilitate or conduct newly-identified transactions related to sanctioned persons, services, or goods.
- **ILC17:** Senate Banking Committee Chairman Brown (D-OH) is now leading a renewed bipartisan charge to limit the ability of nonbanks to use industrial loan companies (ILCs) to gain access to bank privileges without the parent-company supervision required of all other domestic IDI parents.
- **GSE-121923:** The CFPB yesterday released a fascinating research blog looking at cash-out refis.

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