FedFin Daily Briefing

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Barr Presses for Counterparty-Risk Management

FRB Vice Chair Barr today called for large banks to ensure that counterparty exposures are well managed according to actions he describes, announcing no new Fed initiatives in this arena. Mr. Barr was particularly focused on the need for banks to ensure sound margining and to dynamically adjust margins and other risk buffers. He also noted new steps underway by the FRB, including the hedge-fund exposure tests included in the new exploratory stress tests (see *Client Report* **STRESS32**). Given that the talk was before the Basel Committee, Mr. Barr also emphasized the importance of international cooperation.

FSB Cites SEC MMF Global Leadership

The FSB today released its thematic peer review report on MMF reforms, generally finding that global progress on its 2021 MMF rule (see FSM Report **MMF18**) has been inconsistent across jurisdictions. However, U.S. progress is detailed, with the FSB noting key points in the agency's 2023 MMF rule (see FSM Report **MMF20**) despite ongoing concerns about lingering risks such as vulnerability to large and sudden redemption pressure due to large MMF holdings of risky assets. Even so, the FSB details why the Commission decided against expanding floating NAVs to government funds, citing investor reluctance, potential reduction in the size of the MMF sector, and operational and accounting challenges, all of which could lead to reduced wholesale funding liquidity and access to capital for issuers. The FSB plans to address the effectiveness of MMF-related policy measures in 2026.

Fed Staff: Private Credit Poses Banking, Insurance, Systemic Risk

Reflecting concerns most recently expressed by Acting Comptroller Hsu and FSOC (see *Client Report* **FSOC29**), the Fed's new staff paper on private credit contains not only a taxonomy about this fast-growing sector, but also a warning of emerging systemic risk. Differing from the Fed's May 2023 financial-stability assessment of low risk (see *Client Report* **SYSTEMIC96**), the paper argues for greater systemic-risk focus due to illiquidity, rising corporate leverage and default risk, and the extent to which large amounts of "dry powder" and the need to compete with banks for higher-quality loans lead to still more risk-taking. The paper also points to contagion risk to P&C insurance investors and increasing interconnections with banks as systemic hot spots. The paper also notes that the Basel III rules could, the study says, accelerate credit-market migration outside the banking system, making private credit still more important to credit-market functioning despite its structural risks. In addition to describing key private-credit attributes (e.g., lender concentration) and recent, "exponential" growth, the paper notes that the largest investors in private credit are pension funds, which hold about one-third of these assets, followed by other funds; insurers and high-wealth individuals hold relatively small shares. The paper notes that data gaps make risk analytics challenging, but assesses a large sample of private credit obligations from 2013 to 2023. Private-credit obligations are found to be riskier than syndicated loans, in part because so many involve private-equity sponsors affiliated with the lender, growing use of covenant-light loans, higher LGDs, and sharp reductions in borrower debt-service capacity.

HFSC Mark-Up Includes Partisan Measures and Crypto, Capital, Systemic Proposals

The agenda released today for HFSC's Thursday mark-up includes numerous bills designed to achieve GOP objectives with agencies such as the CFPB, FinCEN, and HUD. These will take considerable time due to how controversial they are, but may well not advance to the House floor, let alone in the Senate. However, the panel will also take up a resolution to repeal the SEC's controversial staff accounting bulletin related to crypto-custody assets (see FSM Report **CUSTODY5**), a resolution that will enjoy considerable bipartisan support. Bipartisan agreement is also likely for bills introduced by Rep. Sherman (D-CA) to force capital recognition of AOCI (now also pending in the capital proposal) and Green (D-TX) to demand more transparency when the banking agencies and Treasury invoke systemic risk as they did following the mid-March bank failures.

Bowman Also Worries About New Liquidity Regs

Expanding her focus now to liquidity regulation, FRB Gov. Bowman today pushed back against the revisions outlined by Acting Comptroller Hsu and perhaps even the more modest agenda outlined by Vice Chair Barr. Criticizing the agencies' lack of regulatory prioritization, she pressed for better regulatory coordination and calibration to limit burden yet still ensure ample liquidity. Ms. Bowman also noted that many comments have pointed to key impact concerns with the capital rules and, while significant changes are necessary to address unintended consequences, she is hopeful that she will be able to support final standards. She remains opposed to the current CRA rules, climate-risk principles (see FSM Report **CLIMATE17**), and the proposed debit card interchange fee cap (see FSM Report **INTERCHANGE12**).

GOP Tries a New Tack to Quell Asset-Manager ESG Voting

Continuing the GOP campaign to curb asset-management ESG activities, House Oversight Committee Chair James Comer (R-KY) today attempted to force the Fed's hand in making a decision about whether asset managers are no longer passive investors and thus could be considered BHCs or trigger changes in control for their influence voting bank stock. In a letter to FRB General Counsel Mark Van Der Weide, Rep. Comer focuses less on how asset managers actually vote stock, but whether their membership in various coalitions in which members commit to use proxy-voting power for ESG purposes gives them a controlling interest. Smaller asset managers that are signatories to these agreements are also said in the letter to be exercising control, with the letter also noting FDIC Director McKernan's recent speech suggesting it does. The letter seeks answers as quickly as possible to an array of questions about the extent to which the Fed monitors asset-management activities in ESG coalitions and asset-manager proxy voting, if membership in a coalition focused on using proxy-voting power suffices to constitute control, and what the Fed plans to do both with regard to monitoring and reconsidering its prior no-action determinations.

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-021624:** In this report, we build on our in-depth analysis yesterday of the Fed's new stress-test scenarios to focus on their mortgage-market impact.

- **STRESS32:** In this report, we assess the strategic and policy implications of the Fed's new stress-test regime.

- **LIQUIDITY34:** Today's HFSC Financial Institutions hearing on emergency liquidity featured much discussion of reform, but few indications of any action Congress will take to advance it apart from support for pending agency efforts to enhance discount-window readiness.

- **FSOC31:** Treasury Secretary Yellen's hearing today before Senate Banking followed the path set in Tuesday's HFSC session (see *Client Report* **FSOC30**), with Ms. Yellen refusing to take a stand on matters such as the capital rules and banking-agency supervisory effectiveness.

- **FSOC30:** As anticipated, today's HFSC hearing with Treasury Secretary and FSOC Chair Yellen showcased sharp Republican criticism of the Council's nonbank designation authority (see FSM Report **SIFI36**), with Chairman McHenry (R-NC) and Financial Institutions Subcommittee Chairman Barr (R-KY) citing the guidance as yet another example of regulatory politicization, calling FSOC a "rogue" and "roving" regulator.

- **MERGER14:** Although all of the banking agencies have for years promised a new bank-merger policy, none has proposed one until this OCC rulemaking.

- **PAYMENT28:** Today's Senate Banking Committee hearing on scams and fraud in the banking system focused on the rise of P2P payment app scams, the growing popularity of traditional methods of fraud executed via wire transfer and check fraud, and emerging crypto and AI risks.

- **AI5:** Although FSOC's latest annual report highlights AI risk, it does not request any express agency action, a hands-off approach that led to bipartisan legislation demanding a more forceful approach.

- **GSE-013124a:** Common-stock investors clearly think so, but they're a notably speculative lot and more than likely wrong.

- **GSE-013124:** We have reviewed the 2024 scorecards FHFA released for Fannie and Freddie.

- **CONSUMER55:** The CFPB has followed up a controversial proposal to set prices for larger-bank overdrafts exempt from certain consumer standards with a proposal to simply ban certain non-sufficient fund (NSF) fees when banks decide in real time to decline a consumer-payment request.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com