Policy Update
November 17, 2009

The FHA fund is getting much weaker, the FDIC is essentially borrowing from the entities it insures, and Fannie Mae announced nearly $20 billion in losses in the third quarter. Not the free-fall we experienced earlier this year but still a very ugly picture. As Congress and the Administration continue work on a stunningly broad range of financial reform issues, these grim statistics provide a reminder to policymakers that some changes need to be made that would not happen in a normal environment.

Congress was in recess this week and action will resume next week with the House Financial Services Committee's expected completion of work on systemic risk legislation. Chairman Frank will offer an amendment to assure that any FHLBank deemed to be systemically important would not be subject to loans-to-one-borrower limits which would have resulted in huge reductions in advances.

Senate Banking Committee Chairman Chris Dodd (D-CT) Introduces Reform Bill

This week, Chairman Dodd unveiled an 1136-page bill that incorporates in one document all the bills that have been working through the process in the House – systemic risk, derivatives, a new Consumer Financial Protection Agency (CFPA), regulatory restructuring and others. The Dodd bill differs in a number of ways from the House bills. The two largest differences are the greatly diminished role of the Federal Reserve in the Dodd vision of the new world order, and the combination of all prudential financial regulators into one large agency.

The exemption from the CFPA that FHLBanks achieved in the House legislation is not in the Senate draft. Other identified issues, such as subjecting FHLBanks to concentration limits should they be identified as systemically important and relief from new derivatives provisions for FHLBanks as end users, are issues that will have to be addressed in the weeks ahead.

The Banking Committee plans to vote the bill out of committee by the end of the year. If the legislation garners no Republican support in Committee, it will not be considered by the full Senate until it gets some bipartisan support.

The Federal Deposit Insurance Corporation (FDIC) Meets on Securitization and Insurance Prepayments

The FDIC board considered securitized assets on the balance sheet of failed banks as well as the plan to require banks to prepay three years of insurance premiums. The FDIC proposed a safe harbor through March 31, 2010, for all asset-backed securities at receiverships. Since 2000, the FDIC's resolution powers prevented the seizure of securitized off-balance sheet assets, but a recent decision by the Financial Accounting Standards Board moves securitized assets onto banks' books. The change raised questions whether the FDIC would now control these assets in the event of a failure, alarming some investors that they may face losses if an originating bank collapses. The FDIC will put out for comment the question of whether to impose conditions on future securitized assets in order to keep the safe harbor.

FHFA's Inspector General Post Remains Vacant

The Obama administration continues to search for an Inspector General for the Federal Housing Finance Agency (FHFA), vacant for the 15 months since FHFA's creation. The pressure to nominate an appointee may increase with frustration in Congress over lack of reform proposals for Fannie Mae and Freddie Mac. FHFA Acting Director Ed DeMarco submitted an appropriations request for the position, but any action requires presidential appointment and Senate approval.

Total Bank Failures in 2009 Up to 120

Five more banks collapsed in November, bringing the total number of bank failures in 2009 to 120.

Federal Reserve Bank of Richmond Releases Paper on Removing Crisis Support

The Federal Reserve Bank of Richmond published a paper titled "Rolling Back the Financial Safety Net" last week, one of many policy studies this year considering the effects of government involvement in the financial sector. While the paper makes no mention of the Federal Home Loan Banks, it does explore the implicit government subsidy of some institutions which "provides an incentive to banks to acquire risky assets offering a high rate of return without having to increase their capital buffer commensurately." The paper concludes by contending healthy banks would be better off without the government's "safety net," and the practice of borrowing short- term, low-cost funds to invest in long-term, illiquid assets must stop.