FedFin Daily Briefing

Wednesday, October 16, 2019

FSB Secure in Knowledge of Post-Crisis Financial Stability

Continuing its reports to world leaders, the FSB today reiterated that the post-crisis framework under its authority has achieved its objectives save for the extent to which national agencies have failed to set a proper example by rapid action to implement and enforce it. As we will shortly note, the FSB's sanguine perspective is in sharp contrast to the IMF's, which is considerably more pessimistic about financial-market stability and supportive of additional policy interventions.

The FSB report does reiterate concerns about growing leveraged-lending risk, high debt levels, snap-back risk. Work also continues on stablecoin, fintech, and decentralized financial entities. For the first time, the FSB now says that nonbank financial intermediation (once less flatteringly called shadow banking) no longer presents risk since aspects of it that contributed to the great financial crisis have sharply declined. The FSB also defends itself from assertions about unintended consequences, stating that efficient credit allocation is sufficient to support the "real economy." Household lending is sufficient and its cost is low, although the FSB does acknowledge that this is in part due also to accommodative monetary policy. Remaining work is to focus on insurance and CCP resolvability, asset-management vulnerabilities, OTC-derivative reporting, and peer reviews. Global work on a pre-positioning accord for large banks does not appear to be a priority; as we noted earlier this week, the agency plans to propose some possible options in a mid-2020 consultation.

IMF Fears Financial-Sector Risk, Procyclicality, Macroeconomic Spillovers

In contrast to the sanguine FSB forecast analyzed earlier today, the IMF's semi-annual financial report today is downbeat and even alarmist. In sharp contrast to global regulators, the Fund points to declining bank profitability and low market capitalization as near-term risks. U.S. Dollar-funding is a cause of significant concern at non-U.S. banks. Reflecting its pessimistic macroeconomic forecast, the Fund also calls on nations such as the U.S. to trigger macroprudential tools to reduce procyclicality (e.g., the CCyB).

Risk arises in part because the IMF finds that $19 trillion of corporate debt repayment would be threatened by a crisis half the magnitude of the 2008 one. Reiterating its longstanding concern about lower-for-longer rates, the Fund also notes that $50 trillion of bonds now have nominal negative rates, the Fund calls for continued financial reform, restrictions on insurance yield-chasing, and – for the first time – new monitoring of and disclosures from institutional investors to identify correlation and liquidity risk. The FSB is not concerned about nonbank financial intermediation, but the Fund calls for strengthened sector oversight. High-risk emerging markets now have debt of 160 percent of exports compared to 100 percent in 2008, leading the Fund also to call for some sort of new sovereign-debt management facility. Clearly, the IMF remains opposed to modern monetary theory despite all its internal debate about the adverse impact of post-crisis austerity policies.

Brainard Outlines Barriers to Stablecoin, Challenges to CBDC

FRB Gov. Lael Brainard today reinforced FedFin's forecast that Libra, for all its travails, has forced the Federal Reserve to consider the meaning of money as an urgent policy priority. Gov. Brainard made it clear that any stablecoin venture with global scale and scope needs to address regulatory questions before launch. Key include AML/CFT compliance, clear statements of consumer rights and related enforcement, legal-responsibility assignment and enforcement, the limits of activities offered by the stablecoin provider in concert with payment services, and resulting systemic risk. Gov. Brainard emphasized that neither the FRB nor other bank regulators has "plenary authority" over any payment system operating in the U.S. and it is unclear if a stablecoin operator would meet the designation criteria necessary to declare it a systemic financial market utility or to govern its activities as systemic pursuant to an FSOC determination to that effect.

The FRB is also concerned about the ability of stablecoin systems to disintermediate banks and adversely affect economic growth, although the Fed expects banks to adapt by partnering with stablecoin providers, revising their offerings, or redefining their operations. Further, stablecoin could adversely affect central banking and monetary-policy transmission; here, Gov. Brainard is less confident that authorities could or even should adapt by offering central-bank digital currencies (CBDC). Although one senior Fed official recently said that doing so is "inevitable", Gov. Brainard details many reasons why the U.S. central banks should eschew a CBDC. These include the policy problems of government control over individual payments, operational risk, AML risk, and bank disintermediation along with challenges to monetary-policy transmission and risks to financial stability. All this said, the FRB is evaluating CBDC and will, Ms. Brainard said, keep an open mind, looking in particular at cross-border challenges as the new FedNow system (see FSM Report **PAYMENT17**) is implemented.

Gruenberg Cites Challenges to Large Regional Bank Resolvability, Demands Stiff Standards

FDIC Director Gruenberg today buttressed his opposition to new resolution rules (see Client Report **SIFI33**), arguing that the resolvability of large, regional banks remains uncertain. Stating that banking organizations with assets between $50 billion and $500 billion pose "very significant resolution challenges" due to size, complexity, and reliance on credit-sensitive market funding and uninsured deposits. Mr. Gruenberg argues that these differences along with the challenges of purchase-and-assumption transactions for large companies and the absence of TLAC requirements call for stringent regulation.

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As previously noted, the agencies have finalized standards that alter the timing and other procedural aspect of the resolution plans filed by large banking organizations, but the FDIC has its own resolutions standards (see FSM Report **LIVINGWILL8**) for insured depository institutions (IDIs). The agency issued an advance notice of proposed rulemaking (see FSM Report **LIVINGWILL20**) exploring ways it might change its approach or even drop it in recognition of the new "tailoring" framework, but Mr. Gruenberg's comments today indicate stiff resistance to any such action. He is, however, interested in mandating TLAC for large regionals.

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 requests@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about GSE Activity Reports, click: http://www.fedfin.com/index.php?option=com_content&view=article&id=18&Itemid=18

- **CONSUMER32:** In this report, we assess CFPB Director Kraninger's appearance today before a partisan and rancorous HFSC.

- **SIFI33:** In this report, we assess the Federal Reserve Board meeting approving final versions of the FRB's tailoring standards (see FSM Report **SIFI31**), inter-agency tailoring standards (see FSM Report **SIFI30**), the parallel framework for foreign banking organizations (see FSM Reports **FBO8** and **FBO9**), and FRB/FDIC resolution-plan requirements (see FSM Report **LIVINGWILL19**).

- **GSE-101019:** In our most recent in-depth analysis of the challenges confronting FHFA's capital rewrite, we assessed the complexities inherent in meeting the Administration's equivalence objective.

- **GSE-100419:** Continuing the build-out of bank-equivalent standards, FHFA issued its first-ever compliance guidance for Fannie Mae and Freddie Mac.

- **GSE-100219:** Here, we turn to FHFA's 2018 capital proposal and subsequent FHFA and banking-agency actions to assess what FHFA will have to do to achieve the capital-equivalent framework established as part of the Administration reform plan.

- **GSE-093019:** As anticipated, FHFA and Treasury announced the quarter-end agreement allowing Fannie and Freddie to raise capital reserves to $25 billion and $20 billion respectively.

- **GSE-092619:** In its latest white paper, FHFA's OIG analyzed CECL's impact on Fannie, Freddie, and the FHLBs.

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- **DERIVATIVES35:** Reflecting strong industry pressure and growing concerns about market structure, the banking agencies have joined others with which they share jurisdiction to propose a significant revision reducing the capital cost of the 2015 margin rule for non-cleared derivatives.

- **PAYMENT18:** This report assesses the Senate Banking hearing on the Fed's proposal to own and operate FedNow to speed U.S. adoption of faster payments (see FSM Report **PAYMENT17**).

- **SYSTEMIC87:** Although the HFSC Subcommittee on Consumer Protection and Financial Institutions hearing was convened to discuss draft bills, including one to overhaul the nonbank SIFI designation process, these were not substantively discussed.

- **INVESTOR13:** For the first time since 2007, all five SEC Commissioners appeared before HFSC.

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