FedFin Daily Briefing

Wednesday, September 23, 2020

Fed Focused on Payment-Infrastructure Reform/FedNow Implementation, with CBDC a Long Way Off

The president of the Federal Reserve Bank of Cleveland, Loretta Messer, today defended the payment system against many accusations that slowness and exclusions inhibited effective performance under the pandemic's emergency conditions. However, the industry may need to "rethink" payment investments in light of recent experience, highlighting the need to emphasize scalable technologies such as cloud-based systems, P2P, and cross-border technology. Core-banking system replacements may also need to be accelerated, with all of these comments leading us to conclude that the Fed will focus not only on FedNow (See FSM Report **PAYMENT20**) in 2021, but also on payment-system infrastructure with new standards, guidance, and perhaps even regulation. The Fed may also and at long last roll out longer operating wholesale-payment hours, and review new technical approaches to improve speed, reach, and resilience.

Ms. Messer also reiterated that the Federal Reserve is indeed working hard to evaluate central bank digital currency, noting that the pandemic experience reinforces its need. Like Gov. Brainard, she stipulated that a U.S. CBDC will deal only in fiat currency, saying also that many issues now being studied at the Fed (See FSM Report **CBDC3**) need to be resolved. This will, she said, be a multi-year effort, reinforcing also the fact that the U.S. will move more slowly on CBDC than many other central banks.

Quarles Targets MMFs in Global Reform Agenda

FRB Vice Chairman Quarles today highlighted concerns about nonbank financial intermediation, noting Fed actions have ensured large-bank resilience. He stated more directly than in the past that the Fed's need to provide emergency support in March resulted in part from MMF fragility despite 2014 reform (See *Client Report* **MMF13**). The FSB, which Mr. Quarles also chairs, will deliver its NBFI report to the G20 in November along with a work plan on renewed reforms. Mr. Quarles' speech today suggests that these reforms will focus on liquidity transformation in the funding sector, not broader issues germane to NBFI maturity transformation also of growing systemic concern in the corporate-finance sector. Under questioning, Mr. Quarles indicated that public comment will be sought on the treatment of foreign banks in the LISCC when it picks up work on the supervisory reforms discussed ahead of the COVID crisis.

Powell Takes a Pounding

FRB Chairman Powell took tough questioning today at the House Select Subcommittee on the Coronavirus. This followed release of a staff report highly critical of the Federal Reserve's Secondary Market Corporate Lending Facility which found that issuers of bonds purchased by the Fed have laid off workers although the program's purpose is, it said, to support macroeconomic resilience. Mr.

Powell defended the program, stating that the Fed has no intention of rescuing Wall Street, that the Fed is only buying small amounts of pre-existing bonds, and that "no one is really benefiting" from this facility. Majority Whip and Subcommittee Chairman Clyburn (D-SC) and some panel Democrats countered that the Fed could have set program terms to ensure worker protection. Minority Whip Scalise (R-LA) focused his statements on China's role in the pandemic and the Trump Administration's work to improve the economy, with many Republicans pressuring Mr. Powell to take stands – e.g., on how many schools should close – which he refused to do. Members on both sides of the aisle also demanded changes to make the Main Street program more accessible to smaller businesses. As he did yesterday (See Client Report **COVID15**) and will surely do tomorrow before Senate Banking, Mr. Powell countered that the Main Street facility is not structured for smaller borrowers who are better served by the PPP.

The staff report – sure also to be raised by Senate Banking Democrats – concludes that the Fed's failure to do so means that its facilities benefit corporate executives and investors, not the workers for whom it argues any facility with Treasury backing is intended. Further, Fed practices are, the paper asserts, exacerbating economic inequality by supporting recovery only beneficial to higher-wealth households. Directly confronting Chairman Powell, the report cites his assertions in Congressional testimony that Fed programs are meant to support workers, quoting him also telling Congress that even junk-bond purchases support employment by preventing "big" lay-offs. The report also observes that bond issuers backed by the Fed have laid off approximately one million workers since March even though 383 companies still paid dividends. 227 companies have also been accused of what are described as illegal activities since 2017, and ten percent of issuers were in the fossil-fuel sector even though these companies employ only two percent of American workers.

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

- **AML132**: FinCEN is beginning a process that, while apparently not revising or eliminating any existing anti-money laundering (AML) requirements, would add an over-arching principle that AML programs be efficient, "reasonably-designed," and capable of providing high-quality information to law enforcement and other government entities.

- **COVID15**: HFSC's second CARES Act-required hearing with Treasury Secretary Mnuchin and FRB Chair Powell continued to stress the theme that has become apparent ever since negotiations on a Phase IV relief bill stalled: Democrats primarily want additional direct fiscal support and Republicans are pushing for adjustments to existing relief programs funded by unused 13(3) Treasury backstops.

- **GSE-092220**: As usual, FHFA's new strategic plan is more rhetorical than real. Still, it has a noteworthy emphasis on ending the conservatorship, promulgating new standards, and enhancing inclusion not just at the GSEs and within FHFA, but also in credit access.

- **CRA29**: Emphasizing its new focus on racial equity ahead of several Congressional hearings this week, the Federal Reserve Board today unanimously approved a long-awaited ANPR revising its CRA regulations.

- **GSE-092120**: Late last week, the Federal Reserve Bank of New York announced that the Fed bought almost $56 billion in agency MBS over the past two weeks.

- **GSE-091720**: As anticipated, today's marathon HFSC hearing with FHFA Director Calabria covered a wide-range of issues we will shortly analyze in detail due to the policy and strategic importance of several exchanges.

- **FAIRLEND8**: HUD has largely finalized a controversial fair-housing rule as proposed, with the new standards for adjudicating fair-housing disputes giving defendants numerous additional protections.

- **GSE-091020**: As we noted yesterday in our in-depth analysis, a CFTC subcommittee has issued a landmark report laying out an array of climate-change risks it urges policy-makers to prioritize to prevent systemic and sector risks.

- **COVID14**: Today's Senate Banking hearing on the status of emergency Fed facilities showed even more clearly the dividing lines between Democrats and Republicans on changes to the Main Street Lending program than the CARES Act Congressional Oversight Commission's recent hearing.

- **GREEN4**: In this report, we analyze an influential and possibly even game-changing paper released today by the CFTC's Climate-Related Market Risk Subcommittee.

- **GSE-090320**: As noted in our three summaries of key FHFA comment letters, FHFA was not exactly overwhelmed by heartfelt praise for its GSE capital rule.

- **COVID13.pdf**: As anticipated, today's House Select Subcommittee on the Coronavirus Crisis hearing with Treasury Secretary Mnuchin reflected contentious negotiations over a phase four rescue package.

- **GSE-090120:** In this analysis, we continue our assessment of comment letters to FHFA on the capital proposal.

- **GSE-083120a**: In this report, we begin our assessment of the comment letters on FHFA's capital proposal that we believe carry the most weight in terms both of FHFA's final rule and what Congress may care to do about it.

- **GSE-083120:** A new Fed staff study finds wide disparities among the mortgage rates borrowers pay on exactly the same loan that has nothing to do with risk and apparently everything to do with borrower sophistication.
- **MORTGAGE118:** Despite its pending proposal to overhaul the entire definition of loans eligible for qualified-mortgage (QM) status, the CFPB proposes also to establish an additional class of first-lien, fixed-rate mortgages that are QMs or given a rebuttable presumption of QM status.
- **GSE-082520:** The CFPB's proposal to allow QM treatment for certain seasoned mortgages will rewrite a decade's worth of securitized lending if macroeconomic and interest-rate conditions turn favorable.
- **GSE-082020:** A new study from FDIC staff challenges the predictive models on which much mortgage underwriting increasingly depends, discrediting both workhorse predictive models used across the spectrum of consumer credit as well as the ML-based mortgage models that fare still worse as macroeconomic, policy, and borrower conditions change.
- **GSE-081920:** Weighing into the GSE-evolution question with its formidable analytical might, CBO today assesses a likely administrative solution in which the GSEs retain all of their earnings for a limited period of time following which common stock goes again on offer to the public and Fannie and Freddie go back to being Fannie and Freddie more or less as they were pre-2008.
- **OPSRISK21:** Although the Basel Committee believes that its post-crisis capital and liquidity framework significantly enhanced bank resilience evident in a robust industry response to the pandemic, this crisis and other developments are said to highlight the need for additional regulatory and supervisory work to improve operational resilience.
- **GSE-081720:** With the release late Friday of Chairman Crapo's letter to FHFA, the GSEs' refi fee announcement has taken fire from a high-impact Senate Republican along with Ranking Member Brown and HFSC Democrats.

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