FedFin Daily Briefing

Tuesday, January 19, 2021

IMF: Most CBDC Isn't Legal Tender

Addressing a critical question confronting CBDC, the IMF last week posted a staff note challenging the legal authority enjoyed by most central banks to issue digital currency. Much recent analysis has focused on whether and how central banks should pursue CBDC, but legal authority is clearly a threshold issue. The key to this question is not whether central banks could issue a digital currency if desired, but whether that currency would be legal tender under applicable national law. In general, the study concludes that account-based CBDC is likely to be considered legal tender, but token-based forms raise more questions. Legal obstacles also confront CBDC intended as retail accounts, with most central banks now barred from offering this form of CBDC.

Although the IMF staff surveyed 180 countries, they provide virtually no information on individual nations. FRB Chairman Powell last week said that the U.S. has not decided whether to issue CBDC and, should it do so, it will move carefully given the dollar's reserve currency status. Work under way by the Fed (see *Client Report* **CBDC3**) appears to presume legal authority, but the Fed in 2019 said that this remained an outstanding question. Democrats are sure later this year to seek to settle it by pressing legislation mandating "FedAccounts" via a "digital dollar" (see FSM Report **CBDC**), but the odds of enactment are low to moderate due to Fed and GOP opposition, remaining complexities, and other Congressional priorities. Any determination that CBDC is not legal tender in the U.S. will more likely be taken up when the Fed decides how to proceed.

Yellen's Top FinServ Priorities: Systemic Designations, AML, Climate Risk

Although the Senate Finance Committee hearing today considering Janet Yellen's nomination to be Treasury Secretary largely focused on national-debt, stimulus, and tax matters, many questions, as expected, also provide insight into the sharp financial-policy-priority changes under the Biden Administration. In response to questions from Sens. Toomey (R-PA) and Cantwell (D-WA), Ms. Yellen confirmed our assessment (see Client Report **FEDERALRESERVE59**) that firm-specific FSOC designations will again be considered, action strongly supported by incoming Senate Banking Chair Brown (D-OH). She also indicated that activity-and-practice designations will advance, citing in particular her work on FSOC addressing leveraged hedge funds and open-ended mutual funds as targets that need to be taken up again. Ms. Yellen also committed to working with Congress to implement provisions in the NDAA regarding AML (see FSM Report **AML133**), prioritizing the new beneficial ownership registry and promising to get it up and running as quickly as possible given it is a national security issue. Ensuring cryptocurrencies are not used for money-laundering and terrorist-financing is also a key concern. Ms. Yellen also will quickly begin a review of sanctions policy, saying sanctions are a critically important tool to address cybersecurity and other threats as well as to tackle China's growing challenge.

Responding to a question from Sen. Whitehouse (D-RI) noting that Freddie Mac has warned that coastal property values could crash, Ms. Yellen called climate risk an "existential threat." She will appoint someone at a "very senior" level to lead Treasury's climate efforts, create a hub to review financial-system risk, and begin work on a climate-risk disclosure regime. She also will review actions taken by Secretary Mnuchin and FHFA Director Calabria with regard to housing finance reform, saying a careful review is required before she begins to work with Congress to craft a bipartisan solution. Sen.

Brown reiterated that he has laid out a different path to housing finance reform than the Treasury/FHFA plan, saying he looks forward to working with Ms. Yellen to enact it.

FHFA Takes Lead in Sizing Financial Climate Risk

Following the Fed's climate-change warning for residential real estate, FHFA today issued a request for input seeking views on climate and disaster risk as they affect Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. We will shortly provide clients with an in-depth analysis of the RFI, which begins the process of sizing climate risks in order to assess current supervisory policy. Similar efforts are likely from each of the banking agencies as the Biden Administration's climate-risk focus spurs action ahead of renewed Congressional demands for stress-testing and new disclosures. Comment on the FHFA's request will be due ninety days after *Register* publication.

Large BHCs Get Capital-Plan Relief, SLHCs Get New Rules

The FRB today finalized proposed capital-planning standards (see FSM Report **CAPITAL226**) aligning these requirements with 2019's broader tailoring construct (see FSM Report **SIFI34**) and the stress capital buffer (see FSM Report **CAPITAL225**). The new rule formalizes the end to stress-test qualitative objections, significantly eases capital planning for Category IV banks, revises certain capital-plan assumptions, and – its most significant change from the NPR – brings SLHCs into the new capital-planning construct and the stress capital buffer. Although the overall rule does not change capital requirements, the Board calculates that SLHCs will come under higher requirements due to this revision. The rule is effective sixty days after *Register* publication and is not likely to be challenged by the new Congress.

In addition to the final rule, the accompanying staff memo indicates that the Fed has revised two supervisory letters governing capital-planning for Category I banks (SR 15-18) and the other for Categories II and III banks (SR 15-19). These guidance statements detail the Fed's supervisory expectations and have been updated to reflect the new rule.

FDIC Restarts Large-IDI Resolution Plans

Following a contentious meeting approving 3-1 a new FDIC supervisory-appeals process, the FDIC board met in closed session and then issued a statement ending the moratorium on resolution-plan filings by IDIs with assets over $100 billion. This restarts the FDIC's own, more stringent resolution-planning standards (see FSM Report **LIVINGWILL10**) which are separate from those governing BHCs and IHCs in conjunction with the Fed. The planning process will not start for IDIs without a year's advance notice, but the agency is nonetheless telling these organizations to prepare for inquiry, one the agency thinks now warranted in part by growing pandemic stress. A newly-modified approach to planning to streamline filings and other requirements will also be issued in coming weeks. Further action on a 2019 ANPR governing IDI plans (see FSM Report **LIVINGWILL20**) does not appear to be contemplated going forward.

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.

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- **GSE-011521:** Last night, Treasury and FHFA announced an agreement on the GSEs' conservatorship unsatisfactory to all concerned and highly objectionable to many of those on the Hill with the power to change it.

- **GSE-011321:** Setting Senate Banking's agenda yesterday, incoming Chairman Brown highlighted refi inequality as a top committee priority.

- **CRYPTO17:** This interpretive letter (IL) follows an OCC advance notice of proposed rulemaking that suggested a notice-and-comment process before the agency made substantive changes to the digital-currency powers of federally-chartered banks.

- **AML133:** In a cliff-hanger before the end of the 116th Congress, the National Defense Authorization Act was enacted into law with an array of provisions significantly revising U.S. anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements.

- **ELECTION25**: It will take considerable time for Congress to absorb the meaning of yesterday's insurrection not only in institutional terms, but also and more immediately with regard to each Member's thinking about his or her own policy and political agenda.

- **TMARKET**: As we noted earlier (see *Client Report* **REFORM200**), we do not expect U.S. regulators to extend SLR relief (see FSM Report **LEVERAGE23**) after its scheduled March expiration.

- **GSE-010421**: It's not exactly news to suggest that the Biden Administration will take a more demanding view of the GSEs' affordable-housing obligations than the Trump Administration.

- **DEPOSITINSURANCE111**: Easing restrictions from a proposal already intended to facilitate additional funding from products then considered brokered deposits, the FDIC has finalized new rules creating a new brokered-deposit framework in which funding relationships long considered brokered deposits instead may be gathered without impediments even by under-capitalized insured depository institutions (IDIs).

- **GSE-122820**: As we noted last week, FHFA is barreling through the systemic rulebook, finalizing capital rules, proposing liquidity standards, and, now, laying out living-will requirements to ensure orderly GSE resolution under even acute stress

- **CRYPTO16:** Late Wednesday, the President's Working Group on Financial Markets (PWG) issued yet another unprecedented U.S. policy statement, following one on MMF reform just the day before with a statement from Treasury, the FRB, SEC, and CFTC on U.S. stablecoin policy.

- **MMF16**: Late yesterday, the President's Working Group on Financial Markets (PWG) issued an unusual report signaling agreement by Treasury and the FRB, SEC, and CFTC on the urgent need for changes in the MMF sector to prevent systemic "dash-for-cash" events such as the most recent March crisis.

- **GSE-122320:** It's beginning to look a lot like a major policy theme: research continues to show that GSE mortgages cost Black and Hispanic borrowers considerably more than non-Hispanic whites, especially over the course of a loan, not just at origination.

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- **FEDERALRESERVE59**: It's hard to envision a Federal Reserve still more central to every aspect of U.S. macroeconomic, financial, and fiscal policy, but that's what FedFin forecasts for 2021.

- **ILC15:** Setting the stage for new charters and legislative battles in 2021, the FDIC has finalized a controversial proposal addressing source-of-support and certain other obligations for the parent companies of some industrial banks and industrial loan companies (ILCs).

- **GSE122120:** As previously noted, FHFA late last week issued a long-promised proposal implementing LCR- and NSFR-like – but not light – rules for Fannie Mae and Freddie Mac.

- **CONSUMER36**: On Monday, the Biden transition released a readout of a meeting between Treasury nominees Janet Yellen and Wally Adeyemo with various racial-equity associations, reinforcing the importance this issue will have in crafting financial regulation in the Biden Administration.

- **GSE121720**: FHFA's controversial capital rule is in today's *Federal Register*, setting an effective date of February 16.

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