FedFin Daily Briefing

Tuesday, June 1, 2021

FSB Ramps Up Cross-Border Payment Reform

Advancing a G20 priority, the Financial Stability Board today continued its work on cross-border payments, asking for views on quantitative targets for its cross-border reform objectives. These include improvements in cost, efficiency, and the inclusiveness that increasingly characterizes a wide array of U.S. and global payments initiatives and work on CBDC. The FSB's focus is also to ensure that cross-border payments continue through the regulated banking sector, not through alternative channels such as cryptocurrency or private stablecoins. Although high-level goals and principals are common in FSB documents, specific targets such as those now proposed are unusual in global efforts such as this because they permit greater accountability not only of the FSB, but also national systems that often operate at wide variance to FSB goals despite signing on to them. As will be analyzed in a forthcoming in-depth FedFin report, the new quantitative targets cover end users in the wholesale, retail, and remittances markets. Nations would need to meet these goals by the end of 2027, although remittance-related ones could be postponed until 2030. The targets themselves will be finalized in October for the G20, with comments on this consultation due by July 16.

Biden Budget Sidesteps Key Financial Policy Questions

Although the Biden Administration's first official federal budget includes many controversial and specific proposals, it is as always a wish list, not a guide to what Congress is likely to do nor even necessarily what individual agencies will undertake apart from actions directly germane to funding. The credit-and-insurance section of this budget, like its predecessors, addresses financial-sector concerns such as housing finance and the FDIC, but it is generally silent on key policy questions. For example, the section on the GSEs says only that the Administration looks forward to working with Congress on reform. The FHA section is only slightly more specific, implying by the numbers presented that the Administration will not reduce FHA premiums rather than expressly laying out any policy on this important question. The budget implies, but does not directly state, support for the FDIC's decision to defer any premium increases under the pending DIF restoration plan.

Quarles Throws Doubt into Prospect of SLR Rewrite

Taking a less certain stance than Chair Powell (see FSM Report **REFORM203**) in March, FRB Vice Chair Quarles today said that changes to the SLR are "likely," but there are also other ways to address deposit growth. Although in March the Fed said it would soon issue a proposal for SLR changes, Mr. Quarles today also said that the Fed is still considering if any changes are needed and, if so, their timing.

Continuing the Fed's positive view of the banking system's resilience (see Client Report **SYSTEMIC91**), Mr. Quarles stated that banks would have been resilient during the pandemic even without extra fiscal and monetary support. Rejecting suggestions that the Fed's actions in March exacerbated moral hazard, the vice chairman noted that these facilities used during the pandemic are unlikely to be useful in the future given their unique design. Although banks are beginning to relax underwriting standards, Mr. Quarles believes this is appropriate. Continuing his stance on climate stress testing (see Client Report **REFORM206**), Mr. Quarles questioned whether it will ever be sensible to use tests to impose capital requirements. Regardless, he believes such a stress test remains far in the future.

BIS Study: U.S. Deposit Scarcity Subdues Small-Business Lending

A new BIS staff study uses both empirical evidence and models to find that U.S. income inequality adversely affects the ability of banks to intermediate deposits into small-business loans for very small entities, thus hindering small-business job creation. However, the study to us appears at best to demonstrate correlation, not causality, thus complicating its use assessing the extent to which regulated banking is essential to small-business credit availability. Many factors not considered by the BIS researchers were at work during the period studied (1980-2015), including a significant change in the reliance of banks on local deposits on which the paper depends to demonstrate differences in the ability of banks to gather deposits and then to make small-business loans. Sharp changes in bank regulation and ultra-low interest rates after 2008 were likely also to have had a significant impact on bank small-business lending not assessed here. Although the paper posits (correctly in our view) that upper-income households rely less on deposits than on other financial assets for wealth accumulation, this does not necessarily translate into deposit scarcity that would then provide a possible causal link to less bank small-business lending. Indeed, deposit levels have generally been robust through much of the period studied even though small-business lending dropped significantly.

BoE's Bailey: No Case for Climate Capital Requirements

Tackling a question also bedeviling the Federal Reserve, Bank of England Governor Andrew Bailey today opposed incorporating climate change into capital requirements, emphasizing instead the central bank's work to improve climate disclosures, scenario analysis, and risk management. Although the Bank of England is considerably ahead of the Fed in terms of mandatory climate stress testing, Mr. Bailey said that the case for capital requirements has not yet been made. Indeed, he is uncertain it ever will be made despite the initial outlines of "brown penalty charges" in a recent BIS report (see Client Report **GREEN**). The Bank of England also differs from the Fed in that it has "greened up" its asset holdings along with recrafting monetary policy to recognize climate risk in part by using the Bank's portfolio to create incentives for corporations to change their own climate policy. Directly tackling a problem also bedeviling the Fed, Mr. Bailey also laid out the reasons why climate risk-mitigation is in his view consistent with a central bank's mission.

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.

- **GSIB19**: Although the GSIB CEOs got another earful at HFSC's marathon hearing yesterday, it – like the Senate Banking session that preceded it (see Client Report GSIB18) – generated more anger than clear action plans.
- **CRYPTO18**: Following an array of actions by the OCC, the FDIC has begun its consideration of the rules governing insured depository institutions (IDIs) engaged in digital-asset activities.
- **GSIB18**: As anticipated, Senate Banking progressives today excoriated big-bank CEOs for what Chairman Brown (D-OH) describes as their preference for profit over public welfare.
- **ACCESS**: The Federal Reserve's latest wellbeing survey provides important, new insights into how Americans view their financial-services firms at a time of heightened focus on access and equity.

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- **REFORM206**: In the one-two punch we anticipated, Senate Banking Chairman Brown (D-OH) convened today's hearing with FRB Vice Chairman Quarles not only to lambast supervision and regulation under Mr. Quarles' watch, but also to reiterate the malign role he believes big banks play in the U.S. economy ahead of tomorrow's hearing with GSIB CEOs.

- **GSE-052521**: President Biden has issued an executive order (EO) setting in motion a series of administrative actions designed to reduce both climate risk in the financial sector and in any way financial companies make it worse.

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- **GSE-052021**: Using its formidable trove of non-public data, the Federal Reserve Bank of New York has released a series of staff reports assessing the status of mortgage forbearance.

- **REFORM205**: Although the banking agencies today tried to make as little news as possible in their appearance before the House Financial Services Committee, Members made it hard for them to leave the witness table without providing important insight into regulatory policy as a new agency line-up takes shape.

- **INTERCHAGE8:** Leaving its interchange-fee restrictions intact – at least for now – the Federal Reserve is proposing to expand on its existing requirement that all debit-card transactions must be enabled for processing on at least two unaffiliated payment-card networks for card-not-present (e.g., online) transactions.

- **GSE-051821**: As we noted yesterday in our initial assessment of FHFA's annual CRT report, its assessment of the critical 2020-21 period shows an unbending determination to quash all but the best-capitalized credit-risk transfers no matter the pressure from Congress and other quarters to relent on grounds that risk transfers reduce GSE risk and thus spur recapitalization and privatization.

- **DEPOITINSURANCE112**: Although federal law expressly bars misrepresentation of FDIC-insurance status, the FDIC has observed increasing instances that might at the least be described as confusing, many of which led to informal enforcement actions.

- **GSE-051221**: A new Fed staff paper sharply questions an axiom of mortgage securitization: the sanctity of the TBA market.

- **SYSTEMIC91**: In this report, we assess the details of the Fed's most recent financial-stability report, focusing on policy and regulatory ramifications with near-term strategic impact.

- **GSE-051021**: As detailed in a new FedFin report, the Fed's proposal to open payment-system access is far from the technicality many nonbankers take it to be.

- **PAYMENT22**: When the Fed announced its new instant payment system in 2020, it made it clear that access would be limited to traditional insured depository institutions (IDIs) and ever since has shown no public inclination to open the system.

- **INVESTOR7**: Today's HFSC hearing on the lessons of GameStop featured SEC Chairman Gensler for his first Congressional appearance in this new role and, as detailed in this report, a lengthy list of initiatives now under way at the Commission not only on equity-market trading integrity and systemic risk, but also

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Archegos and digital currency.

- **GSE-050521**: Ahead of possible systemic designation for Fannie and Freddie, FHFA is barreling through the systemic rulebook, finalizing capital rules, proposing liquidity standards, and, now, finalizing living-will requirements to ensure orderly GSE resolution under even acute stress.

- **GSE-050321**: The month of May may not be merry in Washington, but it's always consequential. Legislation with any serious hope of success in this session of Congress should be showing signs of determined life by now under ordinary circumstances.

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