FedFin Daily Briefing

Friday, June 25, 2021

FRB-Chicago: Structural Change Could Avert Mandatory Treasury Central Clearing

Tackling one of the toughest questions as regulators seek to reform the Treasury market, staff at the Chicago Federal Reserve bank have released a post concluding that structural change is required before central clearing is possible and that such structural change might on its own facilitate central clearing without the need for an official mandate. Incoming Treasury Under-Secretary Nellie Liang is among those favoring central clearing but Chairman Powell has expressed reservations about it. These include changes at the current clearing house (FICC) to permit client clearing and/or creation of new trading venues for trading among non-clearinghouse members. This all-to-all model has been suggested by FRB Gov. Brainard, but the post – for all its advocacy of non-mandatory options – notes that all-to-all trading requires costly segregation and an array of new rules to prevent undue volatility. We conclude that this would at the least require additional research about the costs and viability of these alternatives before it is possible to affirm the post's conclusions about the value of voluntary options to central clearing.

EBA Clarifies How Banks Issue Climate-Risk Bonds with Capital Bonus

In connection with a broader technical review of its capital rules, the European Banking Authority yesterday laid out ways bank-issued ESG bonds could count for capital or TLAC purposes. The U.S. has yet to undertake any similar exercise, likely in large part due to the lack of national "green" standards akin to those in the EU, but this is a growing trend in capital regulation that could well be reflected in forthcoming U.S. proposals to implement the "Basel IV" package. ESG bonds in the EU are used to fund a bank's own efforts or those of its clients across the spectrum of climate-risk considerations. To the extent the bonds are capital/TLAC-eligible, they are of course a desirable issuance that increases bank willingness to undertake climate-risk mitigation – an issue at which the banking agencies and Treasury are also looking in light of the Presidential climate-risk order.

The EBA guidance and best practices do not address continuing EU concerns about "greenwashing," taking bank representations about climate impact on face value and instead focusing on the need to ensure that any ESG bonds used for capital and TLAC purposes have explicit, adequate documentation of risk considerations such as subordination. ESG bonds with performance triggers would be ineligible capital/TLAC instruments, with the guidance stating that funds raised via eligible debt must be fully available to cover a bank's balance sheet regardless of the status of the funded project. There may also be no incentives to redeem.

New CFT Standards Emerge for Extremist Financing

Today, the U.S. Treasury commended several FATF actions, suggesting the U.S. will move as quickly as possible also to implement them. Novel in the AML/CFT arena is a new report examining the financing of racially or ethnically motivated extremists. It urges nations to include this risk in their terrorist-financing risk assessments, a move already under way in the U.S. to a limited extent. The FATF also adopted new guidance requiring the assessment and mitigation of proliferation financing risks and completed its second annual review of the implementation of revised FATF standards on virtual assets and virtual asset service providers. This concluded that risk remains due to inadequate AML/CFT implementation in many countries despite progress. No near-term recommendations are specified although FATF plans to develop them.

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.

- **CBDC6**: As previously noted, the BIS has released its most full-throated endorsement yet for CBDC. This not only puts further pressure on central banks – the Fed very much included – to accelerate work, but also on the shape of emerging CBDCs.

- **GSE-062321**: There is much rejoicing in mortgage-industry land that the Supreme Court decision today means rapid repeal of Mark Calabria's regulatory legacy and still more rejoicing among affordable-housing advocates about GSEs yoked to a new public-welfare and racial-equity mission without any hope of an end to the conservatorship.

- **CHINA16**: The Senate has passed by a wide margin legislation taking an array of actions to counter the threat now seen to be posed by the People's Republic of China.

- **GSE-061721**: We have reviewed FHFA's massive report to Congress on its 2020 activities, finding only lots of handy facts and no significant policy insights.

- **GSE-061621**: As detailed in our new in-depth report, the Basel Committee is proposing a new regulatory framework for bank exposures to cryptoassets that will influence not only what banks do in this critical arena, but also what the GSEs can do and thus what happens to the digital mortgage.

- **CRYPTO19**: Advancing some of the most controversial ideas in a 2019 discussion paper, the Basel Committee has now formally proposed capital, liquidity, risk-management, and supervisory standards it believes nations should apply to bank cryptoasset exposures.

- **CBDC5**: Kicking off Congressional action on CBDC, the hearing today in Senate Banking's Economic Policy Subcommittee made it clear that, as we forecast, progressive Democrats such as Chairwoman Warren (D-MA) are strong supporters of a U.S. CBDC that not only facilitates payments, but also supplants retail banks and other private-sector consumer-finance entities.

- **GSE-060821**: This Friday, FSOC will meet in closed session to craft its agenda for 2021 and beyond. Housing and the GSEs will figure prominently in this work plan, but not as you might think.

- **PAYMENT23**: Continuing work on a priority set by the Group of Twenty heads of state, the FSB in consultation with other global bodies is seeking views on how best to measure progress towards the G20's goal of a faster, safer, cheaper, transparent, and inclusive cross-border payment system.

  CBDC4: Members of Congress have launched an initiative to secure continued dominance of the dollar as the globe's reserve currency, focusing on the extent to which China could over time threaten this via its own CBDC along with strategic financial activities such as its Belt and Roads initiative.

- **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.

- **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.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com