Monday, November 8, 2021

BIS Research Survey Finds Few Structural, Policy Impediments to Fast-Acting CBDC

A new BIS paper assesses CBDC's impact across the full spectrum of economic activity given the centrality of data, moving the research discussion beyond the "reserves for all" approach (i.e., FedAccounts) on which much public debate focuses. This work thus tackles critical privacy, competition, integrity, and stability issues largely left aside in the BIS's recent formulation of retail-facing CBDC. Press today indicate that the French have given tentative support to a wholesale-facing CBDC even as they raise the questions this BIS paper seeks to answer.

As with all recent BIS work, this paper concludes that structural CBDC risks can be mitigated with proper design. For example, national efforts to enhance public trust in the domestic currency and an account-based CBDC design are said to reduce the risk of currency substitution. The status of the dollar as reserve currency depends, the paper says, on U.S. policy far more than CBDC functionality. The paper opposes a permissionless, DLT infrastructure on efficiency and environmental grounds; permissioned DLT may be possible, but it raises additional concerns that lead the paper to recommend reliance on a centralized operational design akin to current payment infrastructure.

The research survey is said also to confirm the BIS's view that CBDC should be a public-private construct with tightly-supervised payment providers. To ensure competition, the central bank should set low fees. Consumers should control their own payment data and its monetization, but CBDC cannot be as anonymous as cash without threatening an array of social-welfare and enforcement considerations. Implications for banks are found to be hard to discern from the current literature due to the lack of dynamic modelling, leaving the question of bank disintermediation and financial stability unanswered after considering questions such as changing big-bank business models and small-bank funding challenges. However, the paper still concludes that CBDC might actually increase systemic stability by alerting central banks to incipient systemic runs which may well be limited not only by the safety of housing funds in a central bank, but also by its ability to allocate funds to high-risk investment banks or other causes of systemic instability. The paper finally observes that CBDC's manifold benefits should lead to a reconsideration of the extent to which banks remain too big to fail via deposit insurance and the other subsidies big banks are said still to enjoy.

HFSC Dems Urge LGBTQ+ Financial Guidance

Ahead of its hearing examining financial-inclusion barriers for the LGBTQ+ community, HFSC's majority staff memo indicates the Diversity and Inclusion Subcommittee will tomorrow debate draft legislation that would require federal financial regulators to issue guidance on LGBTQ+ inclusion. The memo cites research finding that LGBTQ+ customers face significantly higher loan denial and lower homeownership rates than non-LGBTQ+ customers, with the share of unbanked in the LGBTQ+ community also greatly exceeding that of the overall population. Democratic staff also urge a streamlined process to allow transgender consumers to update their first and last names. We expect this legislation to advance quickly in the House and, even if it does not, for the banking agencies to take up guidance along these lines in coming months.

Inter-Agency Treasury-Market Rewrite Takes Shape

Ahead of a conference next month, the Intra-Agency Working Group on Treasury Market Surveillance today set principles to guide further action to stabilize the U.S. Treasury marketplace. We will shortly provide clients with an in-depth analysis of the report which, as we forecast at the start of this year (see Client Report **TMARKET**), looks not only at increasing market transparency in terms of both data and venues, but also at central clearing, govvie fund liquidity, and the role of the SLR. As we noted, Chairman Powell last week declined even to consider SLR relief until broader Treasury-market reforms advance. Our preliminary review of the inter-agency report from the Treasury, FRB, FRB-NY, SEC, and CFTC suggests that the approach now under consideration will focus on non-bank intermediaries and their regulation rather than on SLR relief.

Hsu Demands Top-Down Climate-Risk Management

Acting Comptroller Hsu today followed up last week's announcement of near-term OCC climate-risk guidance for big banks with a set of questions he urges directors use to press senior management to action. Noting that directors should challenge any managerial confidence that climate risk is indeed being well addressed, the goal of this inquiry is climate-risk readiness by the end of next year. The specific questions boards should pose relate to a bank's actual exposure, with the board pressing for granular information where overall data are problematic and for near-term scenario analyses. Boards should also demand information on counterparty, sector, and geographic credit risk, the bank's carbon-tax vulnerability, operational resilience, and possible opportunities. Based on a "range-of-practices" assessment starting this week, the OCC will follow its supervisory guidance with detailed standards addressing the issues Mr. Hsu now outlines only for effective governance.

Bowman Reiterates Need for Servicer Readiness, Regulation

Fed Gov. Bowman today told Fed-supervised mortgage servicers to prepare for increased operational risks as COVID forbearance programs wind down, warning that Fed supervisory staff are working with large servicers to ensure they are ready. If this is true not only of banks but also across all large servicers, then Gov. Bowman is cautiously optimistic about the broader economy. However, Gov. Bowman also reiterates her long-standing call for like-kind activities to face like-kind regulation with a strong focus on the nonbank servicers that, she says, narrowly escape the worrisome fate feared in FSOC's end-2020 report.

Looking at housing's impact on monetary policy, Ms. Bowman warned that continued increases in the cost of housing both to own and rent adds to current inflationary pressures, which if large enough could threaten the Fed's monetary policy goals. Indeed, supply issues underlying the price increases are unlikely to reverse materially in the short-term, suggesting higher inflation due to rental and home purchases housing will not suddenly quickly subside, a more hawkish view than clearly evident in last week's FOMC statement and Chair Powell's follow-up.

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.

- **CRYPTO21**: As noted yesterday, the President's Working Group on Financial Markets (PWG) was joined by the OCC and FDIC yesterday issuing a report calling for prompt Congressional action to regulate stablecoins and, even in its absence, also for fast action by federal regulators and the FSOC.
- **GSE-102821**: FHFA is proposing a new disclosure regime designed to bring Fannie and Freddie into the public marketplace in a fashion analogous to large U.S. banks.
- **CONSUMER37:** As anticipated, HFSC's hearing today with CFPB Director Chopra skidded over a wide

range of policy issues.

- **GSE-102721:** After years of enforcement inactivity, the OCC has issued a tough set of restrictions against one of the increasingly few large mortgage servicers still willing to be a banks.

- **GREEN11:** As we noted yesterday, the Financial Stability Oversight Council has now complied with President Biden's executive order (see FSM Report **GREEN8**), compiling an exhaustive assessment of the financial-stability implications of climate risk and what might best be done about it.

- **CBDC9:** Shortly after the BIS and a group of central banks endorsed a construct for retail-facing central-bank digital currency (CBDC), the Group of Seven (G7) finance ministerial issued these public-policy principles to establish a still broader framework for future action

- **SANCTION15:** Today's Senate Banking hearing with Treasury Deputy Secretary Wally Adeyemo showed bipartisan concern that the Administration is failing to implement sanctions required by law, especially when it comes to China, North Korea, and Russia.

- **MMF18:** Global regulators have now finalized a framework on which national regulators may base the reforms they deemed necessary after the pandemic sparked profound disruptions in this sector.

- **CRYPTO20:** Responding to requests from the G7, G20, and FSB, this report addresses market-infrastructure considerations related to systemically-important stablecoins that do not involve multi-currency baskets (e.g., Facebook's Diem).

- **GSE-101221:** Although the majority of FHA ARMs are now LIBOR-linked, HUD has been waiting for Congress, the Fed, or forces on high to help it set a new benchmark.

- **MERGER8:** Progressive Democrats in the House and Senate have introduced legislation demanding an array of new decision factors governing bank M&A transactions and new or even revised BHC activities.

- **INVESTOR19**: As anticipated, today's HFSC hearing with SEC Chair Gensler covered the full SEC agenda, although members steered clear of the SEC investigation demanded by Sen. Warren (D-MA) into recent Fed trading.

- **CBDC8**: As we noted last week, the BIS and seven major central banks have advanced global CBDC policy with three new reports evaluating key design features.

- **GSE-093021a**: Now that we have FHFA's comment deadline – November 26 – we expand our initial analysis of FHFA's capital rewrite into a more detailed assessment of its strategic impact.

- **REFORM209**: In very sharp contrast to the Senate Banking session on Tuesday with Chairman Powell and Secretary Yellen (see Client Report **REFORM208**), today's HFSC session was largely devoted to partisan wrangling over monetary policy, the debt ceiling, and the Biden Administration's overall fiscal policy.

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