Thursday, December 9, 2021

IMF Presses for Fast, Hard Global Crypto Standards

The IMF today reiterated its commitment to work with global regulators to craft crypto regulation due to inherent risks in the sector exacerbated by disorderly capital flows resulting from regulatory arbitrage. The Fund also calls on the FSB to move farther and faster on global crypto standards that go well beyond high-level principles or increased data gathering. Specific standards should first mandate licensing or other regulation for crypto providers in critical areas (e.g., custody), with rules determined by "use case" -- i.e., function -- so that like-kind rules apply to like-kind activities regardless of whether these are in crypto or fiat currency. Finally, new standards should govern exposures of regulated entities in this high-risk arena. The post makes no mention of Basel's stalled proposal to impose higher capital requirements on bank exposures (see FSM Report **CRYPTO19**), but its tone suggests that the Fund wishes not only to see these finalized, but also in a form similar to the initial, stringent proposal. As noted yesterday (see *Client Report* **CRYPTO23**), the U.S. Congress is just beginning to contemplate specific changes to U.S. law and rule in this fast-growing, controversial arena.

FRB-NY Tackles Maternal-Health Inequity

Although Reserve Banks are facing harsh criticism from Senate Banking Ranking Member Toomey (R-PA) about "woke" actions he believes beyond the Fed's mission, the New York Federal Reserve today released a study of maternal health that – despite public concern in this area – may spark renewed criticism with problematic implications for Vice-Chair nominee Brainard. Conducted in conjunction with a major nursing school, a Fed official argues that the U.S. cannot have a healthy economy without a healthy population. The study assesses matters such as racial inequity in this arena and includes an array of policy recommendations that are the study's views and not necessarily those of the New York Fed.

LIBOR Fix Powers Through House

By an overwhelming 415-9 vote, the House late yesterday passed H.R. 4616, the Sherman (D-CA) bill providing legal certainty for legacy LIBOR contracts (see FSM Report **LIBOR6**). The bill finally reached the House floor following a revision to the reported bill ensuring that rate resets are not taxable events. These changes and the House's strong vote suggest it will easily clear the Senate, but little easily clears the Senate these days. To press the measure, a recent Banking Committee hearing demonstrated bipartisan consensus on the need for action, but Sen. Toomey (R-PA) did argue that the bill should not give regulators grounds to set rates otherwise subject to contractual agreement. Rep. Sherman believes his bill provides significant flexibility for both benchmark transition and private-sector decision-making, as do the Fed and the sweep of financial institutions hoping for fast action to clarify legacy contracts before year-end.

BIS: Bond Funds Need Radical Regulatory Rewrite

Today, we follow our analysis yesterday of the BIS paper on DeFi regulatory policy with an assessment of another high-impact analysis of open-end funds. The FSB left these for another day when it finalized its MMF options list (see FSM Report **MMF18**), but open-end funds remain a priority matter at the FSOC and FRB (see *Client Report* **SYSTEMIC92**) in concert with hear-term SEC action on MMFs (see *Client Report* **TMARKET2**).

Consistent with prior policy conclusions, the BIS analysis of bond open-end funds (OEF) redemption risk finds considerable financial-stability risk resulting from procyclical fire sales due to significant correlations in holdings, derivatives use, and limited intermediation capacity. Indeed, it finds that bond OEF systemic risk has become considerably worse because of the sector's fast growth (more than double since 2008) and inherent liquidity mismatches. Swing pricing and redemption gates or fees – options also proposed for MMFs – are found ineffective under stress. The paper thus urges bond OEF liquidity buffers with a counter-cyclical add-on and presses for revised redemption terms that coincide with portfolio liquidity, perhaps doing so via ETF-like features such as in-kind redemptions supported by financial intermediaries. Swing pricing might also be revised to reflect correlated risk and resulting collective actions. The BIS does caution that its recommendations require cost-benefit analysis, but it also notes that the bond OEF systemic threat is so acute as to pose macroeconomic risk that warrants substantive, structural mitigation.

FDIC Does, Doesn't, May Advance New Bank M&A Policy

In a most unusual move, the FDIC today announced it did not release an RFI on bank merger policy hours after two directors – Messrs. Gruenberg and Chopra – said it had. There is no word yet from either Chair McWilliams or Acting Comptroller Hsu, the other two sitting FDIC directors, making it unclear if Mr. Hsu agreed to the RFI and the three directors over-ruled the chairman or if procedures were not followed and Ms. McWilliams thus retracted the document. The FDIC has scheduled what seemed to be a routine open meeting on Tuesday at which these procedural issues may be hashed out in public. FedFin will also assess the situation and advise clients accordingly. We note that, even if the RFI is withdrawn by the FDIC, CFPB Director Chopra's separate statement suggests he has authority at the least to request views in an arena made considerably more high-profile by virtue of the President's competition order (see Client Report **MERGER6**).

Despite this fracas, we will provide clients with an in-depth analysis of the RFI because it speaks to issues sure to guide action by the OCC and FDIC as well as pressure the Fed's ongoing review of its own bank-merger policy and that of the Department of Justice to consider the new issues highlighted in the RFI. These include concerns Mr. Chopra has previously expressed about bank consolidation as well as Mr. Gruenberg's longstanding belief that M&A consideration does not fully take financial stability into account. Questions are also posed on high-priority industry issues such as the extent to which nonbank competitors and/or non-HHI indices should be used to assess bank mergers. If the RFI is issued, it will have a sixty-day comment period; how this ties into the many pending M&A applications has yet to be determined.

HFSC Ducks Tough Asset-Management Diversity Demands

Although the majority staff report released ahead of today's HFSC Diversity and Inclusion Subcommittee hearing highlighted several legislative proposals, Members did not address these and instead focused only on oversight. Chairwoman Beatty (D-OH) highlighted the staff report's finding that only a small number of firms collect data on their asset management and underwriting spending on women- and minority-owned businesses, arguing that the lack of measurement results in a lack of investment. Ranking Member Wagner (R-MO) primarily discussed a new GAO report on factors affecting careers for women with STEM degrees. Rep. Gonzalez (R-OH) followed up on yesterday's digital asset hearing, asking about the ways cryptocurrencies can be brought into the diversity and inclusion discussion.

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.

- **GSE-120921**: On Tuesday, HUD and the CFPB opened the door to special-purpose mortgage finance. Now, we expect FHFA to use this safe harbor to mandate express GSE equitable-finance programs and for banks to take much of what's left in all their commitments after George Floyd's murder and turn it into mortgage and other community-finance products.

- **CRYPTO23**: As anticipated, today's HFSC hearing was a marathon session at which industry witnesses defended their business model, Republicans liked it fine, and Democrats worried about a wide array of policy challenges.

- **COVEREDFUNDS3**: The OCC is "clarifying," but also in many respects rescinding one aspect of controversial 2020 rules expanding the "covered funds" under which banks may make equity investments as provided by the Volcker Rule.

- **GSE-120621**: As we noted on Friday, Senate Banking Ranking Member Toomey asked SEC Chairman Gary Gensler a trick question about GSE obligations at the very end of a lengthy letter focused principally on cryptography.

- **GSE-120221**: Two recent studies add fuel to the fire we first spotted late last year: demands for ARMs that only go down.

- **FEDERALRESERVE65**: Continuing the partisan and often-acrimonious tone of the Senate Banking hearing (see Client Report **FEDERALRESERVE64**), HFSC today heard from Chairman Powell and Secretary Yellen.

- **CRYPTO22**: Although the OCC joined other agencies issuing a non-committal "roadmap" for future cryptography actions, the agency at the same time and far more decisively stated that crypto activities are permissible only if they are also safe and sound.

- **FEDERALRESERVE64**: Most of the news at today's Senate Banking hearing revolves around Chairman Powell's concession that inflation may not be transitory and economic growth is now so robust that quantitative tightening might proceed more quickly than planned, pandemic permitting.

- **GSE-113021**: Unsurprisingly, FHFA today raised the GSEs' conforming loan limit to about $647,000 and the high-cost limit to nearly $1 million.

- **GSE-112421**: Because FHFA tends to take its cue from both the Basel Committee on Banking Supervision and its U.S. cousins, we here drill down to look at the housing-finance implications of the proposed global framework we assessed in a recent in-depth report.

- **CLIMATE12**: Following the UN's COP26 climate-risk summit, the Basel Committee has proposed high-level principles guiding risk management and supervision related to both physical and transition climate risk.

- **REFORM210**: As expected, today's hearing with Comptroller-nominee Saule Omarova included an unprecedented amount of fireworks for what is normally a low profile appointment.

- **FAIRLEND10**: The CFPB has followed a study earlier this year finding significant mortgage product and price discrepancies based on race or ethnicity with a request for input (RFI) on the HMDA data on which the study was based.

- **GSE-111721a**: FHFA's new scoring system for the GSEs and CSS is a startling, if unsurprising, mission rewrite.

- **GSE-111721**: As noted yesterday, the CFPB has opened its HMDA rules to a raft of changes

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

- **GSE-111521**: As we noted on Wednesday, the CFPB highlighted Director Chopra's competition focus when it joined other agencies renewing their mortgage-servicing supervisory and enforcement standards.

- **GSE-111221**: As Mark Calabria made clear earlier this year, reform of the Treasury market has direct, major impact on that for agency debt and MBS.

- **TMARKET2**: In this report, we build on our initial analysis of Monday's report from the Inter-Agency Working Group on Treasury Market Surveillance (IAWG).

- **SYSTEMIC92**: Late yesterday, the Federal Reserve released its most recent financial-stability report. As in its predecessor earlier this year (see *Client Report* **SYSTEMIC91**), this report takes a cautious view, counting on continuing bank resilience to counteract old worries, such as asset-price bubbles, along with containing at least some new fears.

- **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.