FedFin Daily Briefing

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Fed Study Attempts to Address Scope of U.S. Macroprudential Risk

Building on prior FRB research on the increasingly porous regulatory perimeter, a new FRB staff study crafts quantitative measures of the U.S. financial system to assess growing macroprudential risk. In contrast to the relatively-sanguine view of asset prices in the Fed's most recent stability report (see *Client Report* **SYSTEMIC92**), the study finds that cyclical credit flows into unregulated institutions are a leading indicator of systemic risk. Given this correlation, continued fintech growth outside the regulatory perimeter is said also to pose macroprudential risk even when products are offered in concert with banks because these arrangements allow banks in fact, if not also law, to escape the regulatory perimeter. Fed macroprudential tools -- e.g., stress tests -- are found to reach no more than one-third of what the study calls all "macroprudentially-regulated" assets.

Covering the period from 1980 to 2020, the paper also argues for more data on the regulatory perimeter to ensure greater regulatory accountability. However, its regulatory-perimeter definition poses several methodological challenges. First, there are no data on hedge funds, private-equity firms, and CCPs; as a result, firms generally outside prudential standards clearly account for a larger amount of financial assets than this study is able to identify and macroprudential risk are likely even higher. Second, the paper considers companies regulated by the SEC and CFTC to be not only regulated in terms of safety and soundness, but also to be financial intermediaries -- a judgment we think uncertain on both statutory and activity grounds. As a result, its overall comparisons of institutions within the regulatory perimeter -- which include these securities/derivatives entities -- is idiosyncratic; the paper also generally fails to reckon with the extent to which SEC/CFTC regulated companies reside in BHCs and thus lead to overlapping regulators with significantly-different prudential requirements. Nonbank "regulated" companies also include the GSEs and insurance companies, with all of these nonbank, regulated companies have a significantly larger share of financial assets than banks. Unregulated entities according to this study are pension funds, finance companies, REITs, and certain other entities.

FRB-NY: Stablecoins Won't Last

The Federal Reserve Bank of New York yesterday posted a paper concluding that stablecoins are not likely to prove a lasting part of the U.S. financial system. We will shortly provide clients with an in-depth analysis of today's HFSC hearing; the staff memo preceding it clearly takes a different stand, as did the PWG's report (see *Client Report* **CRYPTO21**). Noting first that DLT is at best a problematic infrastructure for payment systems (a conclusion also recently drawn by the Fed), this post argues that stablecoins are transient first because they impair liquidity if reserves are sufficiently ample and sterile to ensure payment finality. Second, stable coins that do not tie up liquidity are risky and less fungible. And, finally, the researchers point to an efficient form of digital money: tokenized deposits, which could be handled via DLT and ensure continued liquidity, stability, and the centrality of banks and thus of a regulated payment system. This appears to be a reference to CBDC based on DLT, but the paper thus closes only with suggestions that further work be done on tokenized deposit in case DLT proves a lasting part of the payment infrastructure.

Democrats Detail Beneficial-Ownership Regulatory Standards

Sen. Brown (D-OH) and Reps. Waters (D-CA) and Maloney (D-NY) late yesterday released their comment letter to Secretary Yellen on FinCEN's initial beneficial-ownership standards. The letter generally praises the proposal, including its broad beneficial-owner definition and those for "substantial control," "ownership interest," and "reporting company." However, Congressional leadership urges clarification of the "new proprietorship interest" terminology to make it clear how this relates to ownership and to the underlying statute (which does not include it). Members also fear that the preamble's discussion of identifiers suggests that these identifiers could be used too broadly, but the overall rule is deemed consistent with statutory intent.

Basel Chief Pleads for Tough III/IV Standards

The Basel Committee's new chair, Pablo Hernández de Cos, today told the European Parliament that jurisdictions must quickly finalize the Basel III/IV package of capital reforms. As noted yesterday, Acting FDIC Chairman Gruenberg included these in his near-term priorities, departing from prior FDIC and Fed statements by making it clear that the U.S. standards should strengthen current rules even if this means additional big-bank capital burden. Mr. Hernández de Cos detailed key features of the final standardized risk weightings (see FSM Report **CAPITAL221**), the output floor on internal models (see FSM Report **CAPITAL222**), and the new leverage ratio (see FSM Report **LEVERAGE20**), all standards where European rules may differ from Basel's standards by way of less onerous requirements. Mr. Hernández de Cos opposed any such deviations, emphasizing the long transition, low amount of increased capital, and positive GDP and financial-stability impact. Doubtless speaking also to the U.S., the Basel chief also stressed the importance of jurisdictional action to preserve the broader global-regulatory construct.

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.

- **CRYPTO24:** Today's HFSC hearing on stablecoins makes it clear that the bipartisan legislation Chairwoman Waters (D-CA) prefers is at best a long way off.
- **FEDERALRESERVE69**: As this report details, all three Fed nominees before the Senate Banking Committee today emphasized the vital importance of Fed independence and their anti-inflation zeal to quell GOP opposition and cement it among moderate Democrats.
- **CONSUMER38:** Taking action to advance President Biden's competition order, the CFPB is seeking views on fees which it believes exploit consumers by virtue of unfair competition.
- **GSE-020122:** Nothing could do as much damage to a business based on fee revenue as a determined CFPB inquiry into fee revenue.
- **CBDC10:** Months after initially promising to release a discussion draft on central bank digital currency (CBDC), the Federal Reserve is now seeking comment on whether and how it might create one.
- **GSE-012422**: A new Federal Reserve Bank of Atlanta study adds another element to those prior research argues are evidence of widespread racial discrimination in U.S. mortgage finance.
- **GSE-011422**: As noted in our in-depth analysis of Acting FHFA Director Thompson's confirmation hearing, it's clear that Democrats and Republicans are thinking hard about resurrecting statutory changes to the GSEs' charters.

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- **FEDERALRESERVE68**: At today's confirmation hearing, Gov. Brainard took a lot of the heat on inflation Republicans only mildly mentioned during Mr. Powell's Tuesday confirmation hearing (see Client Report **FEDERALRESERVE67**).

- **REFORM211:** As promised, FedFin begins our 2022 forecasts with this in-depth report on bank regulation.

- **FEDERALRESERVE67:** As promised yesterday (see *Client Report* **FEDERALRESERVE66**), we listened closely today to gauge the extent to which Chairman Powell faces a serious challenge to reconfirmation.

- **FEDERALRESERVE66:** Many of you have asked us to forecast key policy implications ahead of two high-powered hearings this week considering President Biden's top Fed nominees.

- **GREEN12:** Issuing the first formal U.S. climate-risk proposal, the OCC is seeking comments on high-level risk-management principles to set the context for additional, more binding action governing larger U.S. banking organizations.

- **GSE-010322**: New economic commentary from the Federal Reserve Bank of Cleveland assesses several recent studies on homeownership from an investment perspective.

- **MMF19:** In the wake of noncommittal statements from global regulators on ways to address money-market fund systemic risk, the Securities and Exchange Commission has proposed sweeping changes to the 2014 standards adopted after the 2008 crisis.

- **GSE-122721**: Late last week, the NCUA put a small addition into the Christmas stockings already stuffed by the regulator over the past few months with numerous regulatory liberalizations.

- **MERGER10**: Just days after the FDIC chair refused to advance a request for comment on bank-merger policy, the Department of Justice released one signaling agreement with many of the concerns Democrats aired in concert with the RFI.

- **GSE-122021**: As noted on Friday, the Biden Administration's first FSOC systemic-risk hit list reiterates Trump Administration fears about nonbank mortgage companies.

- **GSE-121721**: As noted on Thursday, FHFA continues to tread carefully through the big-bank rulebook, adopting standards said to be like-kind that aren't quite so similar when it comes to critical details.

- **MERGER9**: Released in a highly-controversial fashion (see below) by two Democrats on the FDIC's board, this RFI posits the need for a significant review of mergers involving insured depository institutions (IDIs) due to many changes in the financial industry and, so it says, the lack of substantive competitive analysis over past decades even of the largest transactions.

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