GSE Activity Report

Tuesday, March 15, 2022

A Sort-Of CBDC and the Future of Federal Housing Finance

Summary

Although we have done extensive analysis of a U.S. central-bank digital currency (CBDC) in our sister analytical service, we have not viewed as it as an imminent strategic consideration for housing-finance agencies and financial institutions. However, a widely noted new paper on an alternative – Treasury accounts highlights a CBDC-like construct that could be implemented far more quickly than a Fed-based CBDC with significant residential-finance impact. As a result, we here assess this concept and its consequences.

Impact

CBDC and the new Treasury dollars respond to the explosion of digital currencies along with obvious, costly anachronisms in the still-slow U.S. payment system. We will not repeat the pros and cons of CBDC here, other than to say that the manner in which it is designed will determine the extent to which banks continue to take deposits and thus remain core to financial intermediation. Under most designs, CBDC is agnostic as to how and to whom payments are made, meaning that it would substitute for existing housing-finance payment channels only to the extent it substituted for bank deposits.

To the extent CBDC prevails and the payment system languishes, mortgage investors would likely get paid quicker in still more certain money, but CBDC would not dictate which type of mortgage got paid to whom unless – and this is a remote possibility – the Fed not only created a digital currency, but then also intermediated deposits into socially – or politically designated – asset classes.

Treasury dollars are not a substitute for CBDC, but rather a limited class of money that could be created more quickly under current law and deputized for an array of federal-payment and -policy purposes as outlined by a Harvard Law professor with a former CFTC chairman. These Treasury accounts would focus on un- and under-banked households, thus accompanying or even supplanting the Bank On accounts and other efforts banks have recently mustered to meet this need.

With these accounts, Treasury would also offer new savings-bond and retirement products to provide a cache of emergency savings assumed to be challenging to find within the private banking system. These accounts do pose privacy challenges given that they are housed at the federal government, but they would likely make it easier for LMI households to save in the absence of balance requirements, especially if Treasury offered above-market rates. Although these accounts would also compete with banks, the paper's authors believe they would create positive incentives for banks to enter the small-dollar savings market. Treasury accounts would also clear more quickly than bank funds, giving them a significant edge on banks and add-on equality impact, although we think this would be minimal unless Treasury accounts also house a depositor's wages.

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In addition, the paper contemplates using these Treasury accounts to ensure that federal benefits are quickly transmitted to households so that the complex, cumbersome process evident in pandemic-relief payment transmittal does not repeat itself in future crises. These accounts are also envisioned as channels for federal-benefit payments under ordinary circumstances (e.g., Social Security).

Where does housing come in? Clearly, housing payments are an enormous part of the banking and payment system in which the federal government plays a critical role. As envisioned in this paper, Treasury accounts could have been the vehicle for distributing eviction-prevention payments. Taken one step forward, Treasury accounts could reimburse lenders or investors for principal forgiveness, handle down payment assistance, foreclosure mitigation, or even compensate for reduced P-and-I payments in the downward-facing ARMs some analysts recommend be to redress racial inequities in the refi arena. Section 8 and other federal multi-family housing benefits could also move through these Treasury accounts, commingling federal benefits with depositor funds where households have payment obligations.

Outlook

Is any of this for real? Probably not, unless FHFA, HUD, mortgage servicers, GSEs, or Ginnie see advantage to them in a program sure to give major headaches to banks big and small.

However, we note that President Biden's new crypto-policy executive order presses the Fed hard to craft a CBDC even though the Fed isn't at all sure it wants one. Treasury accounts are a compromise digital accounts within the federal framework that, due to their direct link to LMI households and public benefits, could accomplish at least some of the financial-inclusion and equity benefits sought by CBDC advocates. Thus, although these are a long shot, they're not a no-shot.

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