



FedFin Daily Briefing

Thursday, May 19, 2022

BIS Finds New Shadow Crypto Finance, Risks in Spotlight

The BIS yesterday released a [paper](#) concluding that, while bank exposures in this high-risk sector are small in aggregate, digital assets nonetheless pose systemic risks. The paper uses proprietary supervisory data to find very small direct exposures at any and all GSIBs, but its data dates back to 2020 and thus may not reflect heightened direct positions at some institutions related to trading and futures and the growth in indirect exposures related to customer demand. The flip side of low bank exposure is found to be growth in what is called the "shadow crypto financial system," posing risks to consumers, market integrity, trading, transparency, and AML enforcement. This new system is not decentralized, with the paper reinforcing recent findings by IOSCO ([see Client Report DEFI](#)) about centralized nodes and control and the risks these pose. However, the crypto shadow-market's more traditional risks are found to warrant greater regulatory scrutiny and rapid attention to data gaps to assess spill-overs to financial institutions (e.g., hedge funds) with significant crypto exposures. The paper also recommends that crypto intermediaries (e.g., exchanges such as Coinbase) be subject to traditional clearinghouse regulation in areas such as margining as well as to address systemic risk and gaps in consumer/investor protection, and AML/CFT.

Commerce Asks About CBDC, Payment System

Following the direction of the President's digital asset executive order ([see Client Report CRYPTO26](#)), the Department of Commerce today released a request for comment on enhancing US competitiveness in this sector. In addition to an array of structural and trade questions, the Department seeks views on the impact a CBDC could have on the sector, providing no insight into how Commerce might weigh into the deliberations well under way at the Federal Reserve ([see FSM Report CBDC10](#)) but suggesting to us that pressure from the White House is accelerating work on a CBDC in unexpected quarters. The request also seeks comment on any factors that led to US leadership in the global finance applicable to driving US digital-asset leadership, payment-system implications, and how digital assets affect financial inclusion. Comments are due by July 5.

Barr Breezes By

Today's Senate Banking confirmation hearing with Michael Barr showed the Fed vice-chair nominee in careful form likely to assure him confirmation despite strong GOP opposition. As anticipated, Ranking Member Toomey (R-PA) pressed Mr. Barr hard on Fed politicization, an issue echoed by other Republicans; in response, Mr. Barr assured them that he understood the Fed's narrow mandate and, with regard to climate risk, he supports a focus solely on financial risk that does not lead to credit allocation. Questioned by Sens. Toomey and Rounds (R-MT) about supplementary leverage ratio reform, the nominee pressed for a holistic rewrite of capital rules that also takes pending changes to the Basel framework and liquidity regulation into account. He also told Sen. Rounds that he does not see the need to rewrite current tailoring rules ([see FSM Report SIFI33](#)). Mr. Barr took no stand on bank-merger policy. Republicans also pressed Mr. Barr hard on both his role creating the CFPB and some comments made about them related to it; Mr. Barr apologized for the comments and stands by the need for the Bureau. Sen. Reed (D-RI) demanded action on crypto rules; Mr. Barr agreed, noting in particular the risks posed by

stablecoins. Unsurprisingly, Mr. Barr supports the inter-agency CRA proposal in broad terms ([see FSM Report CRA32](#)), noting also the need to be careful about specifics. Sen. Ossoff (D-GA) renewed his concerns about the economic-inequality impact of Fed monetary policy.

CFPB Tells States to Flex Their Enforcement Muscles

Turning again to actions outside the direct reach of public notice-and-comment requirements, the CFPB [today](#) issued an interpretive rule essentially encouraging states to enforce federal consumer-protection standards. The rule gives states broad latitude to proceed with or without the Bureau on any of the federal consumer-protection standards within the CFPB's jurisdiction, even if the Bureau already has an outstanding enforcement action against the state's target. The interpretive rule also seeks to expand the CFPB's jurisdiction over nonbanks ([see FSM Report CONSUMER41](#)) to the states, telling states to feel free to enforce all of the laws addressed in this rule against "a broad range of entities." The Bureau also describes its preemptive powers as limited, implying that states which proceed to enforce standards tougher than those detailed in federal law will not face CFPB pushback. This further whittles the scope of federal preemption only to state usury ceilings and any other provisions expressly within the jurisdiction only of the OCC.

Fed Finalizes FedNow Framework

The Fed today issued a final [rule](#) laying out the legal framework governing the FedNow instant payment service it is racing to roll out ([see FSM Report PAYMENT20](#)). Although the Board's proposal applying the UCC to most FedNow transactions was controversial, the final rule largely retains it on the grounds that doing so does not pose consumer-protection risk and gives financial institutions essential legal certainty. The Board has, however, clarified that the UCC does not apply in complex transactions. The final rule also rejects suggestions that it define the final time parameter for FedNow transactions (e.g., ten seconds), retaining its "immediate" standard. The final rule also limits the circumstances under which a FedNow payment may be rejected. The rule will be effective on September 1, although its impact will not be felt until FedNow goes live next year.

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](#).

- [CRA32](#): Following much talk about the need to update Community Reinvestment Act (CRA) rules since this was last done in 1995, federal banking agencies have finally agreed on a proposed redesign of standards essential to banks that wish to expand or acquire as well as those seeking strong community ties and the policy and political benefit these afford.
- [GSE-051622](#): As we [noted](#) last week, the federal banking agencies sighed a mighty sigh and heaved up a massive inter-agency [proposal](#) rewriting decades-old standards detailing which activities earn the Community Reinvestment Act (CRA) points essential for any bank's strategic objectives and national

reputation.

- **FSOC27**: With stablecoin markets even more distressed than earlier in the week, today's HFSC hearing with Secretary Yellen was even more emphatic than senators two days before on the need for action ([see Client Report FSOC26](#)).
- **FSOC26**: Today's Senate Banking Committee hearing with Secretary Yellen renewed calls for federal legislation based on recent algo-coin losses and resulting digital-currency market volatility.
- **SYSTEMIC93**: In this report, we assess the new Federal Reserve financial-stability [report](#).
- **CRA31**: The FDIC today led the way with release of a long-awaited inter-agency [proposal](#) updating decades-old CRA regulation.
- **CLIMATE13**: The FSB's report is aimed at establishing global standards that prevent fragmentation along national or regional lines as well as ensuring that regulatory and supervisory actions mitigate climate risk to the greatest extent possible in the face of an array of data and measurement challenges.
- **INTERCHANGE9**: As anticipated, bankers and card networks squared off with merchants at today's Senate Judiciary hearing addressing credit-card interchange fees.
- **GSE-042822**: In this note, we expand on our analysis of the CFPB's new campaign against [nonbank financial institutions](#) to look more deeply at its impact on residential-mortgage finance.
- **CONSUMER42**: Today's HFSC hearing with CFPB Director Chopra plowed much ground broken yesterday before the Senate Banking Committee ([see Client Report CONSUMER40](#)), but several new furrows were also unearthed.
- **CONSUMER41**: Using what it describes as "dormant" authority, the CFPB is seeking comment on a rule setting the procedures under which it expands its authority to nonbank financial companies it believes pose consumer-protection risk.
- **CONSUMER40**: The Senate Banking Committee's hearing today with CFPB Director Chopra was a sharply partisan session with little immediate impact on what Mr. Chopra plans to do to achieve his sweeping new vision.
- **GSE-042122**: In our last CRT [analysis](#), we looked at transaction viability under the Basel IV rewrite set for rapid release once key Fed nominees are finally confirmed.
- **GSE-042022**: As we noted [yesterday](#), the IMF's financial-stability [report](#) includes a searing assessment of fintech risk.