FedFin Daily Briefing

Tuesday, May 24, 2022

BIS Committee Fears Debt Build-Up Poses Systemic Risk

The BIS Committee on the Global Financial System has concluded that sharp increases in household and corporate debt pose increasing systemic risk. This is a considerably more pessimistic view than the FRB lays out in its recent stability report (see *Client Report* **SYSTEMIC93**) in part because it is global, but also because the CGFS is considerably more alarmed by creditors outside the reach of bank regulation. The report details the sharp uptick in household and non-financial corporate debt after Covid struck, looking distributionally at households, corporations, and sectors (e.g., mortgages) to conclude that most nations have significant pockets of acute vulnerability of which central banks remain largely unaware despite data-gathering improvements since the great financial crisis. The paper explores new macroprudential solutions such as debt-service, income limits, sufficient loss-absorbing capital across all lenders, and further steps to dissuade markets that central banks will bail them out without offering concrete policy suggestions. The paper also and indirectly criticizes central banks for retaining ultra-low rates even as borrowing in 2020 and economic growth began to recover, but again reaches no firm judgments as to policy action.

CFPB Creates New Competition Office, Plan

Reflecting its director's continuing focus on consumer-finance competition, the CFPB today recast an office that previously encouraged "sandbox" product launches into an office focused principally on enhancing the ability of small firms and start-ups to compete with big banks, fintech, and bigtech. The announcement reiterates the Bureau's work, as directed by the President (see *Client Report* **MERGER6**) to encourage account portability but mentions only data ownership without providing any insight into timing for this long-delayed rule. Payment networks and credit-reporting agencies are noted as firms with undue market power, but no steps to address them are noted nor does the announcement provide any insight into what the agency plans for bigtech beyond repeating ongoing concerns. The agency also wants to ensure that consumers get the "best" products; how it will make this determination is not laid out.

FRB-Dallas Staff: TALF Worked for CMBS

The Federal Reserve Bank of Dallas has issued a new report documenting the manner in which Fed support at the pandemic's outset supported U.S. commercial real estate. The backstop in this sector was the Term Asset-Backed-Securities Liquidity Facility (TALF), an artifact of the 2008 crisis resurrected in 2020 as the dash-for-cash accelerated across financial markets. Although TALF was not initially intended for CMBS, the Fed opened it for these ABS on April 9, 2020, and thus provided recourse-free loans for AAA-backed obligations at subsidized rates above pre-pandemic levels but well below those in the market at the time. In sharp contrast to other ABS, TALF was used for CRE backed only by legacy CMBS, not newly issued ones as was possible elsewhere across eligible ABS. The Fed is said to have taken this precaution to guard itself from risk related to market-price volatility in the expectation that stable pricing for legacy CMBS would translate into a stable market for new issuances. This proved to be the case, leading the FRB to shutter the program at the end of 2020. Only three small loans remain outstanding. The case is interesting not only in its own right, but also as an assessment of the manner in which the Fed in future might stabilize markets under stress. Karen Petrou's recent talk explored the use of automatic stabilizers for monetary policy now under active fiscal-policy consideration. Future FedFin work will explore these in more detail.

IDIs Sound, but Worrisome Signs

The FDIC's report on banking-sector 1Q data shows that, despite continuing strong earnings and robust credit quality, some IDIs are facing serious challenges. Although the problem bank number dropped by four banks quarter over quarter to 40 IDIs, the assets held by these banks continues to jump. It increased by $3 billion in the first quarter following a surprising jump of $119 billion at the end of last year and now totals $173 billion. The FDIC attributes reduced profitability largely due to higher provisions, but the trend in return on assets is noteworthy. It now stands at 1.00 percent, down 38 basis points or 0.38 percent from 1Q 2021. NIM is little changed, doubtless because recent Fed rate hikes are not reflected in 1Q data.

HFSC Disabilities Hearing Confirms Little Appetite for New Legislation

As anticipated, HFSC's Subcommittee on Diversity and Inclusion hearing today covered issues faced by persons with disabilities such as under-banking, unemployment and housing inaccessibility. Full Committee Chairwoman Waters (D-CA), sensing potential difficulty moving her bill, is now placing pressure on the SEC to require public companies to make disability disclosures. Following the hearing, Rep. Waters and Senate Banking Chairman Brown (D-OH) sent a letter to SEC Chairman Gensler requesting mandatory disclosure not only of disability, but also race, gender, and certain other protected classes in the Commission's pending work on human-capital disclosures. Subcommittee Chair Beatty (D-OH) made it clear that this is an exploratory session, calling for "thoughtful discussion" of policy. Subcommittee Vice Ranking Member Gonzalez (R-OH) is open to considering ways to enhance accessibility without additional legislation through technology and ensuring fair treatment under the law. Although the Democratic staff memo noted that draft legislation is pending to add disability as an ECOA protected class, the nature of this hearing affirms our forecast of low odds for action even in the House this year.

Brainard to Lay Out Key CBDC Considerations

The HFSC staff memo today on Thursday's CBDC hearing confirms that it will be a consequential session. FRB Vice Chair Brainard is the sole witness, allowing her a chance to provide any color she may choose on the Fed's discussion draft (see FSM Report **CBDC10**) in light of her more positive view of its need versus that of Chairman Powell and Govs. Waller and Bowman. The staff memo as usual largely comprises background material, but it does make it clear that the panel is interested not only in what the Fed may wish to do, but how this fits into the broader digital-currency framework and increasing interest in CBDC by other central banks. As noted, we expect Democrats to press for CBDC, albeit without agreeing on what a CBDC should be; Republicans will oppose a CBDC or, for those more open to it, emphasize that it should not undermine private-sector banking or digital-currency offerings. We will provide clients with an in-depth analysis of this session upon its conclusion.

HFSC Backs OLA, Climate Action in FY23 Budget

The House Financial Services Committee today released its views on the FY2023 budget, detailing broad support for the administration's financial stability, climate, and housing efforts to guide its future authorizing work and that of the appropriations committees to the extent they heed HFSC's request. Reflecting only Democratic objectives, the committee's statement strongly opposes any effort to eliminate OLA, an effort Republicans have launched in prior budget cycles, and demands action to curb "megabanks." HFSC Democrats also continue support for the administration's policy on climate change's financial risks (see FSM Report **GREEN8**), including the SEC's climate disclosure rule and adding climate risk in supervision frameworks (see FSM report **GREEN12**). The statement also calls on the FHA to cancel its mortgage insurance premiums as LTVs drop to 78 percent as is now done by private MI.

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.

- **DEPOSITINSURANCE113:** Using a new approach to issuing enforcement edicts – a circular – the CFPB has made use of its controversial decision to bring nonbanks under its ambit to bolster the FDIC's efforts to enhance consumer understanding of which funds are entrusted to FDIC-insured depositories and which may be at greater risk in other hands.
- **CRYPTO27:** Sharp disruptions in cryptoasset markets, and especially those for stablecoins, have energized calls for rapid U.S. statutory and regulatory action along lines initially laid out by the President's Working Group on Financial Markets (PWG).
- **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.

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- **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.

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