



FedFin Daily Briefing

Wednesday, August 31, 2022

Fed Study Highlights DeFi Risks

The Federal Reserve yesterday released a staff [study](#) concluding that DeFi regulation poses unspecified but unintended consequences even as it reiterated and expanded on potential risks. The study notes in particular the inter-connections between crypto and traditional finance that may pose financial-stability risks, but again does not elaborate. It does, though, describe ways in which DeFi and its underlying components pose governance, custodial, liquidity, and other risks arising in part from coding errors, smart contracts relying on third-party data that can be exploited by malicious actors, and blockchain resistance to censorship making it difficult, if not impossible, for governments to prevent illicit financial activity. This Fed study has a different perspective than a very worried report from global securities regulators ([see Client Report DEFI](#)), which focused on retail and trading-platform risks. However, it forms part of a growing body of official conclusions that will underpin action if U.S. regulators are able to reach consensus and go beyond the individual policies that now govern banks ([see FSM Report CRYPTO31](#)) and, via enforcement actions, securities firms. Congress is set in the fall to tackle the jurisdictional battles between the SEC and CFTC targeted by a House [subcommittee](#), but we do not expect any legislative action in this Congress.

FSB's Domanski Reinforces Calls for Holistic Crypto Framework

Dietrich Domanski, the FSB's Secretary General, [today reiterated](#) global regulators' call for a holistic crypto framework to rationalize digital payments so that innovation remains well governed. The FSB itself is working with IOSCO, CPMI, and the Basel Committee to assess cryptoasset standards and develop new standards addressing new risks such as wealth and confidence effects connected to global stablecoin volatility. Global regulators will also send a report in October to the G20 Finance Ministers and Central Bank Governors on regulatory and supervisory approaches to stablecoins and other cryptoassets. At the same time, the FSB will invite public feedback on its recommendations for global stablecoin arrangements and internationally consistent regulation. All of this work is premised on the "same activity, same risk, same regulation" principle, with top concerns including credit and operational risks, global stablecoin runs, and increasing cryptoasset interconnectedness with traditional finance.

Fed Study Details Need For, Challenges to Crypto Regulation

Another Fed study today repeats some of the DeFi study's concerns noted earlier today, but goes on to a broader examination of digital-asset risk based on the Fed's financial-stability methodology ([see Client Report SYSTEMIC93](#)). After echoing the stablecoin reforms recommended by the PWG ([see Client Report CRYPTO16](#)), this report highlights ongoing regulatory challenges including user resistance to regulation, crypto firms that house themselves in safe-haven jurisdictions, and the inability of smart contracts to be amended after enactment. It also notes an array of risks requiring attention, including lending platforms maintaining little-to-no loss-absorbing capacity, blockchains' congestion delays, and lack of collateral standardization and differences in governance centralization between coins that exacerbate stablecoin run-risk.

FHLB System Opened for Possible Reform

Acting on Director Thompson's [promise to Congress](#), FHFA [today](#) announced a sweeping review of the Federal Home Loan Bank System. This will begin at a late-September "listening" session, proceeding then to additional national and regional discussions. The Bureau is also inviting comments on the future of the often-unnoticed GSE with far-reaching financial-market and systemic-risk impact. The agency's announcement highlights what it calls the System's critical role providing market liquidity as well as its affordable-housing support, seeking comment on issues with the System's mission and structure, products, services, collateral requirements, affordable- and rural-housing impact, and membership eligibility and requirements. We will shortly provide clients with an in-depth assessment of likely to be considered issues and this inquiry's impact. [As noted](#), a recent paper by former FRB Gov. Tarullo and colleagues sharply questions the System on mission and stability grounds, with an *American Banker* [op-ed](#) also chastising the Banks for conflicts of interest and poor governance. The deadline for written comments is October 21.

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-083022](#): BofA's new no-down payment [mortgage](#) is another innovative product in which banks use their balance sheets to address their CRA obligations by offering down payment assistance or, as here, flat out nothing down.
- [CRYPTO31](#): Reflecting the concerns voiced in a recent executive order from President Biden and a subsequent request for views from Treasury, the Federal Reserve has joined the OCC in demanding prior notice from banking organizations that wish to undertake cryptoasset activities.
- [GSE-082222](#): A new Federal Reserve Bank of Cleveland [study](#) validates forbearance as a mortgage-market buffer, reinforcing the likelihood that policymakers and servicers will turn quickly to it if current mortgage-market conditions turn ugly under the combined stress of higher rates and slow to no growth.
- [GSE-081922](#): We look here at an interesting [idea](#) from three senior Fannie Mae officials: an index to measure a Single-Family MBS's social impact.
- [PAYMENT25](#): Following considerable controversy surrounding how Federal Reserve Banks grant master accounts, it has finalized a somewhat more explicit set of guidelines along lines proposed the second time the Fed attempted to set guidelines via a "supplemental" proposal earlier this year amending its 2021 effort.
- [GSE-081722](#): [FHFA](#) and [Ginnie Mae](#) today let loose their long, long delayed standards for eligible seller-servicers.
- [INFOSEC28](#): Using another of its tools to set policy without prior public comment, the CFPB has released a circular stating that inadequate consumer-data safeguards may constitute a breach of the unfair, deceptive, or abusive acts or practices (UDAAP) protection standards subject to Bureau enforcement action.
- [FINTECH30](#): Continuing its practice of setting sweeping policy by administrative action without prior

notice or comment, the CFPB has issued an interpretive rule sharply curtailing the extent to which digital advertising and market strategies are exempted from the legal and compliance obligations associated with most parties directly providing consumer financial products or services and those acting as servicers to these entities.

- **GSE-081222**: [FHFA](#), [Fannie](#), and [Freddie](#) yesterday released the results of FHFA's latest stress test, focusing on the severely-adverse scenario in order – or so FHFA says – to push the GSEs to the limit.
- **INTERCHANGE10**: Two senators have reopened questions about the manner in which card-related payments are handled, tackling those applicable to credit cards with a bill mandating that merchants must be given a network choice that is not either Visa or Mastercard in order to, the sponsors argue, increase competition and lower credit-card transaction costs.