FedFin Daily Briefing

Tuesday, November 8, 2022

EU Council Eases Basel End-Game Rules

Ahead of U.S. action on what is now being called the Basel "end-game," the Council of the European Union today announced a set of compromises and delays to finalize the standard. The output floors (see FSM Report **CAPITAL220**) will apply at both the parent banking group and subsidiary banks, but EU banks will have the discretion to consolidate capital at the highest parent level in each EU nation. The Council release provides no details, indicating only "technical improvements" were made to the Basel credit-, market-, and operational- risk standards and small banks now have unspecified breaks, including with regard to disclosure. Press indicates that the technical changes include easier weightings for trade and government finance along with allowing inter-affiliate lending within a banking organization without added capital requirements. Weightings for mortgages may have been further eased, but it is impossible to verify this without the full decision paper, which has not been publicly released. No details are provided on how the EU standards will be "harmonized" with home countries for non-EU banking organizations, thus weakening the rules initially proposed for non-EU branches.

The next step for this agreement is the European Parliament, which must now weigh the battle between the finance ministers who made the Council's decisions and regulatory bodies that continue to oppose them. Press on this agreement indicates that German and French finance ministers were pleased with these compromises, with Spain noting that the new approach properly reflects EU "idiosyncrasies" and the Netherlands opposing any further relief. Press also indicate that the new start date will EU rules will be no sooner than 2025 and all of the rules may not be fully in effect until 2032. The ECB and EBA opposed these changes.

BIS: CBDC Could Boost Deposit Rates, Small Banks

A new BIS staff paper differentiates its analysis of CBDC's monetary-policy transmission impact by distinguishing between the extent to which large and small U.S. banks respond to different rates paid in interest on reserves (IOR). Large banks are found to be unresponsive to IOR changes, making CBDC necessary to force them to increase rates on deposits via the competition channel rather than a traditional monetary-policy tool. To the extent this reasoning takes hold, it could prove potent with Democrats who not only often favor CBDC, but are also increasingly angry about what they see as large-bank failures to raise deposit rates in lock-step with Fed hikes. This paper assesses CBDC adoption by the relative convenience of using a CBDC versus a large or small bank. To the extent a CBDC offered the same interest rate as paid on IOR, monetary-policy transmission would be considerably more seamless and small banks would increase their market share because the convenience difference between large and small banks would be sharply reduced. The paper also observes that a CBDC paying different rates to differently-sized banks could redefine the competitive landscape, presumably to the betterment of smaller banks. This may prove another policy benefit appealing to Democrats as the CBDC debate advances. Unsurprisingly, both the monetary-policy and competition benefits attributed to CBDC rates equivalent to IOR are weakest at low rates and highest as interest rates increase. We would note that all of these conclusions apply, as the study readily accepts, only in regimes with large amounts of excess reserves. Almost in passing, the paper also finds that, if the CBDC pays a sufficiently high rate, funds will flow out of MMFs and similar instruments, increasing policy transmission without adversely affecting intermediation (see *Client Report* **CBDC8**).

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-110822:** In its latest blast on racial equity, the Treasury Department's Office of Economic Policy has issued a blog post cataloguing racial disparities in residential-mortgage finance.
- **SYSTEMIC94:** As we noted Friday afternoon, the Federal Reserve then released its semi-annual financial-stability report in an effort not only to comply with its protocols, but likely also to attract as little attention as possible, with the release and even the report saying only as much about growing risk as the Fed thinks is essential to preserve its credibility.
- **GSE-110722:** In its latest financial-stability report, the Fed is at pains to provide dozens of pages of helpful data with the few systemic-risk conclusions the Board ventures couched in careful prose designed to assure critics that the Fed knows well what's going on without expressing any views that might suggest serious trouble looms or hint that any of what it surveys will alter the Fed's course in terms of monetary policy, regulatory actions, or systemic considerations.
- **DATA3:** Beginning a long-awaited rulemaking process on the extent to which consumers have rights to their own data and how these rights may be exercised, the CFPB is seeking views on an array of ideas and questions to guide future action.
- **OVERDRAFT11:** In conjunction with a Presidential speech and new White House initiative against "junk fees," the CFPB has accelerated its own efforts in this arena with two new policy directives.
- **GSE-102522:** As we noted yesterday, FHFA has decided not only to unbundle second and high-dollar loans from its flat-fee paradigm, but now to do the same for about one in five conventional conforming purchase loans outside these categories.
- **DEPOSITINSURANCE116:** The FDIC has finalized its proposal largely unchanged to raise base Deposit Insurance Fund (DIF) assessments by two basis points (bps) to replenish the DIF by the statutory deadline to reflect deposit inflows that the FDIC no longer expects to be temporary.
- **RESOLVE48:** The FRB and FDIC have moved beyond the resolution-planning requirements mandated in the Dodd-Frank Act then implemented over the years to what could be a new resolution regime for banking organizations considered category II or III companies under the inter-agency tailoring rules.
- **MERGER11:** As promised, this analysis focuses on the OCC and FRB approvals of the acquisition by U.S. Bancorp of MUFG's Union Bank in California.
- **DEPOSITINSURANCE115:** The FDIC board today voted 3-0 to increase DIF assessment rates by 2bps, finalizing its proposal (see FSM Report **DEPOSITINSURANCE114**) and rejecting industry arguments on grounds that a small DIF premium increase now would make a more damaging procyclical assessment increase under adverse economic conditions less likely.
- **CRYPTO34:** Speaking for global banking, securities, and insurance regulators, the Financial Stability Board has taken its firmest stand to date on cryptoassets and outlined high-level and often principles-based global standards to govern them going forward.

- **INTERCHANGE11:** Leaving its interchange-fee restrictions intact – at least for now – the Federal Reserve has finalized its proposal expanding on its existing requirement that all debit- card transactions must be enabled for processing on at least two unaffiliated payment-card networks for card-not-present transactions.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com