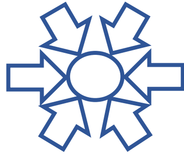

FedFin Daily Briefing

Monday, April 3, 2023

BIS: Banning Capital Distributions Proved Good for Banks, Borrowers

If macroeconomic or market conditions worsen, it seems likely that anxious regulators will look to preserve bank capital and turn to the ban on capital distributions briefly in place at the height of the Covid crisis. A new BIS study of the impact these restrictions had on the EU at the time is thus a timely guide to regulatory thinking under new leadership at the White House, Fed, OCC, and FDIC. The paper believes that it successfully disentangles complex interactions due to overall stress conditions in 2020 and the distribution restraint, finding no adverse impact on credit creation for lower-risk, high pandemic-impact, smaller firms; additional capital buffers; and reduced procyclicality. Notably, banks in danger of under-capitalization regardless of dividend constraints did not increase lending, presumably preserving capital to absorb loss. The paper acknowledges that its conclusions may not be applicable in downturns without the unique characteristics of Covid, with extending its results to banking crises in our view likely particularly uncertain since distribution constraints could accelerate investor flight, turning market-capitalization stress into liquidity and even solvency threat. It is also unclear if the positive results for hard-hit firms would apply in cases without fiscal or other policy support for small-business lending. Interactions with other policies – e.g., the CCyB – warrant additional study, but the paper favors capital-distribution constraints over buffer releases under stress to ensure that funds go into the economy, not to shareholders. It should be noted that the studied EU capital distributions are dividends, not share repurchases – a sharp difference from the U.S. It is unclear if this difference would lead to less favorable results.

CFPB Loads Its UDAAP Bazooka

The CFPB today released what to our initial review appears an explosive new policy statement even though the agency asserts that it sets no new policy. We will shortly provide clients with an in-depth assessment of the lengthy policy on the actions the Bureau believes to be abusive that will not only guide its enforcement actions, but also – or so it hopes – that of other state and federal agencies. While aspects of the new policy codify and build on recent Bureau statements – e.g., re use of "dark patterns" (see FSM Report **FINTECH30**) – others expressly codify the director's focus on "fair competition" targeting "unequal bargaining power" or "profiteering off captive customers." Comments are due by July 3.

BIS Study Finds Retail CBDCs May Counter Financial Shocks

Supporting its overall goal of two-tier CBDC, the BIS released a model-based working paper today finding that the introduction of a retail CBDC that is perfectly substitutable with bank deposits in an open, large economy (i.e., the U.S.) could lower real interest rates and be an effective tool for countering financial shocks. The CBDC's countercyclical utility

leads the authors to recommend that a CBDC's interest rates should be increased during contractionary periods and that it should be paired with automatic fiscal stabilizers. The study also finds that cash-like, zero-interest CBDCs have less welfare benefits than an interest-bearing CBDC and that optimized CBDC policies reduce exchange rate and gross cross-border banking exposure volatility. The authors conclude by noting that the paper might alleviate some policy concerns that a CDBC would result in global financial instability.

Why MMFs Beat Bank Deposits

A new FRB-NY post uses recent evidence to confirm an earlier study that MMFs are more responsive than bank deposits to monetary-policy tightening. Indeed, the data are striking, with MMF rates since March of 22 matching fed funds moves by 97 percent versus an only eight percent match for three-month CDs. Although the difference between institutional investor versus depositor sophistication might account for at least some of the rate differential, retail MMFs almost match institutional rates and thus suggest that retail investors – some of whom are also depositors – also insist on higher rates. The study does not assess retail-depositor sophistication or the extent to which MMF investment minimums give low-balance depositors no choice. The post also notes that a larger Fed balance sheet after 2020 put capital pressure on banks that accelerated flight to MMFs well before tightening, suggesting significant growth in MMs now that rates are rising regardless of still more significant reductions in the Fed's balance sheet. The post does not explore the extent to which the Fed's ONRRP facilitated MMF growth but indirectly validates its importance for monetary-policy transmission, which would not have been as rapid had the financial system relied principally on bank-deposit rates and the Fed's balance sheet remained more or less unchanged.

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-040323:** We have written from time to time about covered bonds.
- **REFORM219:** With Thursday's White House announcement, we know that the Administration will do its best to support Fed and FDIC efforts to color recent events as a failure of Republican-led rulemaking, not also one of agency supervisory acumen, speed, and even competence.
- **REFORM218:** Today's HFSC hearing on recent bank failures was more partisan than yesterday's Senate Banking session (see *Client Report* **REFORM217**).
- **REFORM217:** Today's Senate Banking hearing was extremely well-attended by Senators on both sides of the aisle clearly looking first to understand what precipitated recent bank failures, who is to blame, and what should be done next.

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- **RESOLVE50:** As noted yesterday, the FDIC's recent rescues have had several unusual features with implications not only for future policy, but also for pending special assessments to replenish the DIF for the $22.5 billion estimated costs to the Deposit Insurance Fund.

- **RESCUE79:** Recent editorials and other media have often said that the FRB and/or FDIC have powers or taken actions that is not the factual case as we understand it.

- **GSIB21:** In this report, we assess the implications of recent events on two assumptions underlying current U.S. and global policy affecting GSIBs and those considered domestic SIBs: first, all are likely to be well insulated from illiquidity and/or insolvency and, when this is not the case, then orderly resolution without taxpayer bailout can be readily deployed.

- **LIQUIDITY33:** Among the most vexing issues in the wake of SVB's failure is the extent to which social media may have led to the first "viral run," a run akin to the meme-stock volatility that lead the SEC and others to fear a new form of "flash-crash" risk.

- **GSE-032023:** In this report, we build on FedFin's in-depth reports about recent bank failures to detail new risks for all of the innocent bystanders in the U.S. mortgage market along with a not so-innocent bystander: the Federal Home Loan Banks.

- **REFORM216:** In this report, we continue our policy postmortem of SVB/SBNY and, now, so much more.

- **DEPOSITINSURANCE118:** As promised in our first post-SVB impact assessment (see *Client Report* **RESOLVE49**), this report begins a series of analyses of specific policy issues.

- **RESOLVE49:** As we noted last night, the President concurred with Treasury, the Fed, and FDIC in deciding that SVB's Friday failure and imminent runs on Signature Bank and, most likely, others posed a systemic risk.

- **GSE-030923:** As detailed in our reports earlier this week on Powell's appearance before Senate Banking and HFSC, much was said about the pending rewrite of big-bank capital standards.

- **FEDERALRESERVE73:** At today's HFSC hearing, Chairman Powell modulated his hawkish stance just a bit, continuing as he long has done to refuse to take a stand on fiscal policy while advocating for rapid debt-limit action.

- **FEDERALRESERVE72:** Although Chairman Powell's testimony kept exclusively to monetary policy, today's Senate Banking hearing seemed only to go through the motions set at previous hearings with regard to inflation, growth, and the Fed's long-term objectives.

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