FedFin Daily Briefing

Tuesday, April 18, 2023

FRB-NY Finds NBFIs a Source of Systemic Risk Over the Centuries

Reflecting renewed interest in "narrow banks," the Federal Reserve Bank of New York blog posted evidence of systemic risk from nonbanks in the absence of any banks at all. Looking at 18th-century Amsterdam and thus to be sure at a thoroughly different construct, the post nonetheless shows that Amsterdam's dependence on giant merchant houses exposed it to more systemic risk than England, where a banking system had emerged. Looking at the failure of a Dutch merchant house, Clifford's, the post finds it a precursor of Lehman's collapse in 2008 due to "gambling for resurrection," moral hazard, and inter-connectedness. It is also a forerunner of systemic risks to come if NBFIs overtake regulated banks.

Stablecoin Compromise Faces Steep Challenges

As noted yesterday, HFSC's Digital Asset Subcommittee is set for a Wednesday hearing clearly intended to lay the groundwork for near-term action on Chairman McHenry's (R-NC) longstanding goal of enacting stablecoin legislation. The draft bill released along with the full Committee's staff memo tracks the "ugly baby" bill Mr. McHenry described when he released it last year in concert with then-Chair Waters (D-CA). Rep. Waters has not commented on this year's bill, likely reserving judgment on it based on how it actually emerges from GOP drafting following the hearing and further negotiation. It is not clear if Chairman McHenry will have sufficient support for the bill as is, given that it gives the Fed considerable authority over regulated stablecoins even as the Fed's supervisory reputation is about to be battered in forthcoming SVB hearings. Although Democrats in the last Congress conceded to the GOP and agreed to a CBDC study in lieu of more specific provisions to advance one, the GOP may now be unwilling to countenance even a study of CBDC given fears evident on the campaign trail that CBDCs and even the imminent FedNow instant-payment system are intended to give the Fed control over household purchasing decisions. Republicans in the majority may also be more willing to object to Mr. McHenry's concessions in the last Congress that included community-benefit and racial-equity criteria in the chartering standards for new stablecoin entities. We will provide clients with an in-depth analysis of this measure as it advances; a detailed report on tomorrow's hearing will come ASAP.

Despite Failures, DIF Restoration Ahead Of Schedule

At the FDIC Board's meeting today, FDIC staff said that – while the timing for restoring the DIF to its 1.35% statutory minimum remains uncertain – the DIF could reach its statutory minimum ahead of time and by 2024. As required by law, the special assessment for the cost of recent failures will be accomplished via a forthcoming notice-and-comment rulemaking. Chairman Gruenberg noted that, of the $22.5 billion cost to the DIF from SVB and SBNY's failures, $19.2 billion was attributable to the cost of covering uninsured deposits and will be covered by the special assessment, while the $3.3 billion cost to the DIF from uninsured deposits will not affect DIF recapitalization. Vice Chairman Hill supported DIF counter-cyclicality but highlighted that any industry funds used to finance it could be put to productive use in the economy or promote institutional strength. Director Chopra asked staff how the Board should think about insured deposit growth going forward and argued that the Board should be clear-eyed about its limited ability to make predictions around the insured deposit base. He also urged the Board to consider whether current assessments adequately price risk, and to examine whether some institutions benefited more than others from the systemic-risk exception.

Bowman Remains Staunch CBDC Skeptic

Reiterating that any U.S. CBDC requires Congressional approval, Gov. Bowman today also reiterated her longstanding skepticism to any such instrument. She concludes that CBDCs are unnecessary to include retail-payment speed, enhance inclusion, or accomplish other policy objectives. Indeed, she notes that CBDCs might instead harm consumers and politicize the financial system in general and the Fed in particular. She is less dismissive of wholesale CBDCs and their use for cross-border payments, but still makes clear that a dispositive use case has yet to be determined. As the Fed continues to consider a CBDC, Ms. Bowman is focused on implications for privacy, inter-operability, innovation, the banking sector, and financial intermediation. She concludes that the Fed thus should continue to study CBDC, but only advance one if it is a demonstrable answer to a problem or systemic friction that cannot be addressed through existing systems and/or improvements on them by the private sector. We continue in our view that the future of a U.S. CBDC will depend in part on the extent to which the White House and Treasury press for one, with odds for concrete action significantly less now that Lael Brainard has left the Fed and the election looms.

CFPB Plans Timing Study to Buttress Junk-Fee Regs

The *Federal Register* today includes a CFPB comment request on its “Junk Fees Timing Study,” which would be part of a series of online lab experiments testing differences in consumer choices across different information presentations. Through the study, the Bureau will investigate whether information provided at the beginning of a product search leads to better choices than revealed information as consumer choices occur. The goal appears to be to assess or even validate the Bureau’s view that fees are junk because they are released only at the back-end of product use (e.g., upon an overdraft) rather than clearly disclosed at the outset of product choice. Comments are due by May 18.

Warren, Reed Demand OFR Use Subpoenas To Obtain Systemic Data

Sens. Warren (D-MA) and Reed (D-RI) today urged OFR Acting Director Martin to fill data gaps around financial stability risks posed by climate change, cryptocurrencies, and repo markets. They want OFR to use its subpoena power to obtain these data, also asking whether OFR has collected data on assets held by stablecoin issuers or cryptoasset lenders to assess risks such as those related to reserve assets. The senators also seek information about potential data collections on hedge fund leverage, climate-related financial risk, and cybersecurity, seeking views also on LEIs allow for sufficient aggregation of data from subsidiaries of a single institution. Responses are requested by May 2.

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.

- **CRYPTO41:** As anticipated, HFSC's hearing today with Chairman Gensler was a raucous affair which, while divided sharply on party lines when it comes to Mr. Gensler, also laid out general agreement on matters such as the need for stablecoin legislation (the topic of a high-profile hearing tomorrow).

- **GSE-041323:** As we noted earlier today, global regulators are rethinking their 2015 decision not to require an express capital charge for interest-rate risk, a shift with significant implications for the role of U.S. banks as mortgage lenders and investors.

- **IRR8:** As we noted yesterday, the head of the Basel Committee has targeted two capital and liquidity compromises included in the current Basel III construct not addressed in the end-game rules to which the U.S. plans shortly to turn.

- **COMPENSATION35:** Executive compensation incentives have proved among the most important reform priorities in the wake of recent bank failures.

- **REFORM220:** In this report, we drill down on prior forecasts (see *Client Report* **REFORM219**) of near-term regulatory action to identify the revisions sure to be prioritized as NEC Director Brainard and FDIC Chairman Gruenberg seek to reverse rules finalized over their objections when they were in the minority.

- **UDAP8:** Following its usual practice of setting standards by edict, the Bureau of Consumer Financial Protection has laid out an extensive framework that brings a wide range of consumer-finance actions and inactions within the scope of enforcement sanctions governing acts or practices that are not only unfair or deceptive, but also abusive.

- **GSE-040623:** FHFA, Fannie, and Freddie yesterday updated the sometimes-controversial equitable-finance plans FHFA approved last year.

- **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.

- **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: I**n 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.

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