FedFin Daily Briefing

Tuesday, November 28, 2023

FRB-Dallas: Reciprocal Deposits Require Policy Attention

The Federal Reserve Bank of Dallas today released a staff study revaluating reciprocal deposits in the wake of SVB's failure, concluding that policy-makers should reconsider concentration limits imposed in 2018 in conjunction with brokered-deposit constraints (see FSM Report **DEPOSITINSURANCE108**). Reciprocal-deposit networks are found to provide benefits such as retaining deposits in the banking system and reducing run risk. However, they are akin to brokered deposits in that reciprocal deposits skirt statutory ceilings and place mid-sized banks that are the largest reciprocal recipients at risk of hitting concentration caps. Moral hazard also results, with the short paper concluding that the U.S. deposit-insurance system requires sweeping review. This the FDIC provided after recent failures (see *Client Report* **DEPOSITINSURANCE119**), but the agency focused principally on FDIC ceilings and recommending targeted increases in which Congress to date has shown little interest.

FRB-NY: OEFs Create Run-Run Risk

The Federal Reserve Bank of New York today released a staff study concluding that open-end funds (OEFs) experienced acute outflows after SVB failed, bank deposits received de facto unlimited insurance, and the FRB established the TBFP. OEF outflows lasted for three weeks after the mid-March failures and were experienced across all bond and equity sectors at funds of all sizes with the stress most acute in short-duration funds doubtless due also to rising rates at this time. The study concludes that this experience demonstrates an under-appreciated source of systemic risk when the banking system comes under stress, urging that bank regulators take a broader look at financial intermediation informed by an understanding of the close interconnection between bank deposits and OEFs and resulting run-run risk.

Chopra Testimony Ducks Tough Questions Ahead of Hearings

CFPB Director Chopra's testimony for forthcoming hearings with HFSC and Senate Banking this week largely recaps Bureau action since his last appearance before Congress in June, with Mr. Chopra focusing on consumer debt issues highlighted in the CFPB's recent consumer credit card market report. He also emphasizes Bureau enforcement actions as well as efforts to combat "junk" fees, praising the CFPB's open banking proposal (see FSM Report **DATA4**) and the nonbank payment provider rulemaking (see FSM Report **PAYMENT27**). We will cover the House and Senate sessions and provide clients with in-depth reports ASAP thereafter.

FSB Wants Action on Crypto Vertical Integration

The FSB today released a report concluding that, while multifunction crypto-asset intermediaries (MCIs) currently pose limited financial-stability threat, cryptoasset stress events such as those that occurred over the past year present spillover risks to banks with concentrated deposit exposures to firms reliant on cryptoassets. In light of FTX's failure and the collapse of several "crypto-asset friendly" banks, the FSB finds that the manner in which MCIs combine functions typically separated in traditional financial organizations may exacerbate vulnerabilities, a conclusion Treasury also drew even before these failures in its assessment of risky vertical integration in digital-asset entities (see *Client Report* **CRYPTO32**). The FSB, which does not set out a timeframe, recommends that international standard-setters analyze whether existing recommendations properly address the risks associated with combining MCI functions and more crossborder information sharing. Financial stability implications will depend on how MCIs expand linkages to the financial system and the role MCIs play as the crypto sector evolves.

Basel Presses Supervisors to Enforce GSIB Data-Aggregation Standards

The Basel Committee today released a report finding that only two of the 31 GSIBs are fully compliant with its Principles for effective risk data aggregation and risk reporting (see FSM Report **RISKMANAGEMENT7**). Further, no Principle has been fully implemented. The report also finds that banks are at varying stages of compliance, with many banks establishing compliance timelines that have faltered due to underfunding, fragmented IT landscapes, limited scope, overly ambitious timelines, and a lack of attention from boards and senior management. The Committee thus reiterates its recommendations, emphasizing that bank boards should take responsibility for overseeing data governance frameworks and be accountable for data quality. Without setting a timeline, Basel also presses supervisors not only to increase examination scrutiny, but also to use "forceful measures" to address risk data aggregation and reporting deficiencies.

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-112723:** The most significant thing in FHFA's final capital rule is not what is to be done, but what FHFA left out: ending the GSEs' advanced-approach requirement.

- **DEPOSITINSURANCE122:** As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic, the FDIC has finalized its proposed approach to imposing a systemic assessment to reimburse the Deposit Insurance Fund (DIF) for the resolution costs related to uninsured deposits following a systemic designation.

- **GSE-111623:** As our reports on the Senate and House hearings with bank regulators made clear, our prediction that the agencies would compromise on mortgage risk-based capital requirements will prove itself in the final standards.

- **REFORM230:** Following yesterday's Senate Banking hearing (see *Client Report* **REFORM229**), today's HFSC session with top bank regulators again highlighted growing bipartisan consternation over the unintended consequences of the agencies' capital proposal (see FSM Report **CAPITAL230**).

- **PAYMENT27:** Building on its director's longstanding focus on fintech and tech-platform companies, the CFPB has proposed to extend its supervisory reach to nonbank providers of general-use digital payments services.

- **REFORM229:** Today's Senate Banking hearing with top bank regulators showcased broad bipartisan concern over the interagency capital proposal (see FSM Report **CAPITAL230**).

- **SIFI37:** In concert with finalizing a new systemic-risk methodology, the Financial Stability Oversight Council issued guidance that significantly rewrites the manner in which nonbanks are designated as systemically important financial institutions (SIFIs), largely retaining its initial proposal.

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- **SYSTEMIC98:** Rejecting the Trump Administration's hands-off approach to designating systemically-important nonbank financial institutions or activities and practices, the Biden Administration's FSOC has finalized its bifurcated proposals to designate systemic entities and another laying out an analytical approach to identifying systemic risk that would then guide firm and activity designation as well as Council staff coordination with primary federal regulators.

- **GSE-110823:** Although FHFA calls its FHLB report a centenary event ahead of the System's 2032 birthday, the agency clearly plans structural substantive reform well before that milestone.

- **CLIMATE17:** The banking agencies have joined together to issue inter-agency climate-risk guidance based on proposed standards from the FDIC, OCC and FRB.

- **INTERCHANGE12:** As suggested when the Fed last year finalized controversial new debit-card routing requirements, the central bank is now proposing a sharp reduction in the cap mandated on debit-card interchange fees under the Dodd-Frank Act's Durbin Amendment for debit-card issuers with over $10 billion in assets.

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