FedFin Daily Briefing

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BIS: More Bank Competition Leads to Increased Credit Risk

A new BIS paper looks at a question critical to the debate over bank-merger policy: the extent to which competition drives bank risk-based pricing decisions in corporate lending and, by extension, other credit markets. Using an unusual data set of bank loans in Norway including both hard and soft data, the paper finds that greater competition reduces bank sensitivity to the probability of default and thus relaxes risk-based pricing discipline. Market forces are driven by banks with low franchise value attempting to secure ongoing business – i.e., a race to the bottom. Competition is assessed by HHI indices, the number of competitors, and the effect of new entrants, which are found to offer lower rates and larger loan amounts thanks to looser credit standards. The effects of higher competition are statistically large, with incumbent banks reducing risk sensitivity by approximately 42 percent following the entry of a new competitor. The paper does not make clear if these competitors need to be banks for this effect to be observed; this appears to be likely in the paper's empirical work but not necessary to consider its conclusions. The impact of competition on reduced risk sensitivity is particularly acute in corporate products that depend largely on soft information (e.g., SMEs). Although these conclusions are Norway-specific, they relate to a large body of evidence in both household and corporate credit finding that decreasing bank-franchise value leads to more risk-taking. Although the banking agencies have long observed this phenomenon in U.S. banking (see, for example, the debate over brokered deposits), it has yet to factor into efforts attempting to preserve competition by protecting banks with low franchise value from acquisition unless or until the bank is likely to fail or has already succumbed (see FSM Report **MERGER14**).

OCC Proposes Changes to FOIA Procedures

The OCC today proposed several changes to its FOIA procedures, including allowing expedited processing requests and appeals of denials of these requests and those for fee waivers. In addition, the proposal would omit the "competitive harm" standard for information provided to the government on an involuntary basis due to a 2019 Supreme Court Decision. The FOIA rule thus would rely on an updated definition of confidential commercial information that more closely follows FOIA rather than also rely on the competitive harm standard.

Warren, Progressives Expand Blast on CapOne/Discover Deal to Encompass OCC Merger Proposal

Following other Democratic attacks on the CapOne/Discover merger and her own, Sen. Warren (D-MA) continued her challenge in a letter also signed by twelve House Democrats. The Democrats not only lambast the merger, now adding assertions about Capital One's record of consumer abuse, but also sharply criticize the OCC's pending merger proposal (see FSM Report **MERGER14**), calling it only a codification of the agency's unduly-permissive policy to date. This renews Sen. Warren's strong opposition to the Acting Comptroller's approach to recent mergers, an issue clearly forming a significant obstacle to Mr. Hsu's nomination to serve as Comptroller. The letter also brings the DOJ into the discussion, noting its recent merger guidelines with the FTC (see FSM Report **MERGER13**), stating that DOJ review of the CapOne/Discover deal, should it be approved, is a key test of the President's competition executive order (see *Client Report* **MERGER6**). Notably, the letter does not include any suggestion that Sen. Warren and others will reintroduce her bank-merger proposal of several years ago (see FSM Report **MERGER8**) that would expressly block this transaction.

CFPB Takes Precedent-Setting Step Bringing Nonbanks Under Supervision

The CFPB late Friday released its first contested finding that a nonbank is subject to its supervision following the establishment in 2022 of a process for bringing nonbanks under its supervisory wings (see FSM Report **CONSUMER44**). The release along with the agency's statement on it emphasizes that the targeted company, World Acceptance Corp., has engaged in no wrongdoing, but the supervisory-coverage finding in fact alleges numerous misdeeds at this large installment lender. The process for making such a finding requires that the Bureau conclude that the targeted company poses a risk to consumers even though its actions do not violate law or rule. Drawing on a lengthy discussion of the difference between supervision and enforcement, the order includes a lengthy defense of the reasoning here likely designed to anticipate litigation contesting designation. However, the World Acceptance order goes on to describe not only the target's business and why supervision under the order complies with Congressional intent, but also actions – e.g., bundling insurance and loan products – alleged at the firm to be not only potential harms to consumers, but also actually to have been deceptive or otherwise abusive to consumers. As a result, the distinction drawn in the order between supervision and enforcement for precedential purposes may be short-lived for World Acceptance. Regardless, the reasoning in the order could quickly lead to other contested supervisory designations, including for the nonbank payment companies now facing additional CFPB scrutiny (see FSM Report **PAYMENT27**).

Senate Republicans Introduce Anti-CBDC Bill

Sen. Cruz (R-TX) alongside Sens. Hagerty (R-TN), Scott (R-FL), Budd (R-NC) and Braun (R-IN) today introduced a bill to prohibit the Fed from directly or indirectly issuing a CBDC or even using CBDC as a monetary-policy tool. Going further, the bill requires statutory approval for any form of CBDC the bill somehow might not contemplate. This measure and the companion bill in the House (H.R. 5403) follow calls in 2023 first by Gov. DeSantis and then Donald Trump to bar CBDC on grounds that it would allow the Fed to surveil the American public as much as China does via its CBDC. The House bill was introduced by House Majority Whip Emmer (R-MN) and approved by a partisan 27-20 vote at an HFSC markup in September. The House bill has yet to advance and would face stiff Democratic opposition. The Senate bill has even longer odds given that Sen. Brown (D-OH) was the author of the first U.S. CBDC legislation (see FSM Report **CBDC**) well before the concept was seriously advanced in the U.S. and other nations. It is also notable that Senate Banking's Ranking Member, Tim Scott (R-SC) is not a cosponsor of the Cruz bill. Still, the measure is yet another reminder to the Fed to seek the statutory approval it says it wishes to obtain, authority it clearly will not get as long as Republicans control at least one House in Congress.

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-021624:** In this report, we build on our in-depth analysis yesterday of the Fed's new stress-test scenarios to focus on their mortgage-market impact.
- **STRESS32:** In this report, we assess the strategic and policy implications of the Fed's new stress-test regime.
- **LIQUIDITY34:** Today's HFSC Financial Institutions hearing on emergency liquidity featured much

discussion of reform, but few indications of any action Congress will take to advance it apart from support for pending agency efforts to enhance discount-window readiness.

- **FSOC31:** Treasury Secretary Yellen's hearing today before Senate Banking followed the path set in Tuesday's HFSC session (see *Client Report* **FSOC30**), with Ms. Yellen refusing to take a stand on matters such as the capital rules and banking-agency supervisory effectiveness.

- **FSOC30:** As anticipated, today's HFSC hearing with Treasury Secretary and FSOC Chair Yellen showcased sharp Republican criticism of the Council's nonbank designation authority (see FSM Report **SIFI36**), with Chairman McHenry (R-NC) and Financial Institutions Subcommittee Chairman Barr (R-KY) citing the guidance as yet another example of regulatory politicization, calling FSOC a "rogue" and "roving" regulator.

- **MERGER14:** Although all of the banking agencies have for years promised a new bank-merger policy, none has proposed one until this OCC rulemaking.

- **PAYMENT28:** Today's Senate Banking Committee hearing on scams and fraud in the banking system focused on the rise of P2P payment app scams, the growing popularity of traditional methods of fraud executed via wire transfer and check fraud, and emerging crypto and AI risks.

- **AI5:** Although FSOC's latest annual report highlights AI risk, it does not request any express agency action, a hands-off approach that led to bipartisan legislation demanding a more forceful approach.

- **GSE-013124a:** Common-stock investors clearly think so, but they're a notably speculative lot and more than likely wrong.

- **GSE-013124:** We have reviewed the 2024 scorecards FHFA released for Fannie and Freddie.

- **CONSUMER55:** The CFPB has followed up a controversial proposal to set prices for larger-bank overdrafts exempt from certain consumer standards with a proposal to simply ban certain non-sufficient fund (NSF) fees when banks decide in real time to decline a consumer-payment request.

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