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Regulatory Insights

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Regulation and supervision: Agencies preview forthcoming priorities

As the 2023 regulatory and supervisory agenda takes shape (and the fall conference season ensues), speeches from the banking and financial service regulators serve as a key indicator for regulatory priorities and focus. Collectively, their remarks indicate a focus on certain key areas, including:

- *Digitalization*
- *Crypto assets*
- *Climate-related risks*
- *Merger activities*
- *Fairness/financial access/inclusion*

Key points raised by officials from the FRB, OCC, SEC, and Treasury are outlined below.

Federal Reserve Board (FRB)

Newly sworn-in Vice Chair for Supervision Michael Barr outlined "near-term goals" in a recent speech that he said aimed to make the financial system "safer and fairer." These goals and priorities include:

— Examining **capital** tools and their support of resiliency in the financial system. Taking an "holistic approach," the FRB will:
  - Consider potential adjustments to the supplementary leverage ratio, countercyclical capital buffer, and stress testing
  - Implement enhanced regulatory capital requirements that align with the "final set of 'Basel III' standards" (FRB, OCC, and FDIC each reaffirmed their commitment to Basel III and expect to jointly publish proposed new capital standards for large banking organizations later this year).

— "Rigorously reviewing," alongside the FDIC, firms' **resolution plans** or *living wills*, including clarifying expectations and pursuing remediation when necessary. The agencies will also look at the resolvability of large non-GSIB institutions "as they grow and as their significance in the financial system increases."

— Improving **bank merger analysis**, including consideration of advantages to be gained weighed against the risks posed to competition, financial stability, and consumers and communities.

— Bringing **stablecoins** within the prudential regulatory perimeter, through legislation. Further, expecting banks engaging in crypto-related activities to manage their associated novel risks and ensure compliance with all relevant laws and guidance, including those related to money laundering.

— Providing **climate change**-related guidance to large institutions in conjunction with OCC and FDIC covering identification, measurement, monitoring, and management of the financial risks of climate change. FRB will launch a pilot micro-prudential scenario analysis exercise in 2023 to assess the long-term climate risks facing large banks.

— Focusing on **fairness** across **financial capability**, **financial access** (or inclusion), and **consumer protection** and **"**basing policy on a deeper understanding of human decision-making, and the contexts in which households and businesses make those choices."

Office of the Comptroller of the Currency (OCC)

Acting Comptroller Hsu provided updates and elaborated on what the OCC sees as key long-term threats to trust in banking, including digitalization, climate-related risks, inequality, and complacency. For each of these threats, the OCC's priorities, include:

— **Adapting to Digitalization**
  - Taking a "careful and cautious" approach to crypto-related activities, including requiring banks to obtain supervisory non-objection before engaging in certain crypto-related activities (FRB and FDIC has similar requirements).
  - Subdividing bank-fintech arrangements into cohorts with similar safety and soundness risk profiles and attributes to clarify focus on risks and risk management expectations.
  - Understanding how bank and fintech business models are reconciled in partnerships and the impacts to consumers, competition, compliance, and the overall industry.
  - Incorporating digitalization into the agency's five-year strategic plan.

— **Managing Climate-related Risks**
  - Determining next steps, in coordination with the FRB and FDIC, regarding principles for climate-related financial risk management for large banks; imperatives include: 1) coordinating and harmonizing across jurisdictions (OCC believes convergence among domestic and international regulators is achievable in the near- to medium-term), and 2) operationalizing scenario analyses and prioritizing diverse approaches to such efforts over "one-size-fits-all" stress tests.
  - Engaging with state trade associations and community banks regarding supervisory and regulatory actions related to climate-related risk management.
  - Establishing a new Office of Climate Risk with direct reporting responsibility to the Acting Comptroller.

— **Addressing Inequality**
  - Working with FRB and FDIC to move forward on the CRA proposal.
  - Encouraging banks to reform overdraft programs.
  - Focusing on compliance with fair lending laws.
  - Reducing structural barriers to financial inclusion, including through multiple workstreams under the Project REACh initiative: 1) affordable homeownership, 2) inclusion for "credit invisibles", 3) revitalization of minority depository institutions, and 4) access to capital for small and minority-owned businesses.

— **Guarding against Complacency**
  - Recommending boards and senior management focus on both novel, complex, long-term risks, as well as basic, shorter-term risks, such as those associated with the current rate outlook and mixed market signals impacting credit risk.
  - Engaging with FRB, FDIC, and DOJ on review of the bank merger framework, with particular focus on merger impacts to communities, concentration risks, potential for firms to become "too big to manage," and financial stability concerns.

Securities and Exchange Commission (SEC)

SEC Chair Gensler provided remarks on crypto tokens and intermediaries:

— SEC is working directly with crypto "entrepreneurs" to register and regulate crypto tokens as securities, as appropriate. SEC suggests most tokens in the crypto market, including stablecoins, likely meet the definition of **"securities"** under the Howey test, which requires registration and regulation by the SEC, as well as disclosures to investors.

— Flexibility, such as "tailoring," in the application of existing disclosure requirements may be warranted.

— **Intermediaries**, whether centralized or "decentralized" (DeFi), must register with the SEC if they provide crypto-related services such as exchange, broker-dealer, custodial and clearing, and/or lending functions; registration could result in entities needing to disaggregate some of these functions to mitigate conflicts of interest and enhance investor protections.

— To the extent CFTC needs greater authorities to oversee and regulate **crypto "non-security" tokens** and related intermediaries, "SEC will work with Congress to achieve that goal consistent with maintaining the regulation of crypto security tokens and related intermediaries at the SEC." Certain crypto intermediaries may require dual registration.

Treasury

Assistant Secretary for Terrorist Financing and Financial Crimes Elizabeth Rosenberg provided remarks on Treasury's three areas of work related to countering corruption:

— **Analyzing the risks** associated with corruption**.** Treasury's 2022 Money Laundering Risk Assessment outlined persistent themes of corruption and their impacts on the financial system, including fraud, embezzlement, bribery, extortion, and others

— Employing the right **regulatory framework** to counter corruption in our financial system**.** Efforts include establishing forthcoming rules around beneficial ownership and disclosures for large, all-cash residential real estate purchases as well as work, through the FATF, to strengthen global beneficial ownership standards.

— Implementing **targeted measures,** (e.g., sanctions) to expose and hold corrupt individuals and their facilitators accountable.

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