FedFin Daily Briefing

Tuesday, September 7, 2021

U.K. Joins U.S. Sharp Crypto Condemnation

The head of the U.K. Financial Conduct Authority, Charles Randell, today echoed SEC Chairman Gensler's wide-ranging concerns about cryptocurrency but also targeted U.K. action at social media in ways not yet voiced in the U.S.. Indeed, Mr. Randell's concerns are so grave that he suggests that most consumers may well need to be barred from holding cryptoassets as investments given their vulnerability to social media and the high risks posed by many offerings in this sector. Mr. Randell also highlights the role of social-media influencers in what often prove to be pump-and-dump schemes. The U.K., like the U.S., has enforcement power over pump-and-dump perpetrators, but not over the platforms Mr. Randell says facilitate them and thus warrant regulation. Echoing recent comments that one major crypto platform, Binance, is simply outside the FCA's reach, Mr. Randell also called for international coordination to ensure that problematic providers do not operate out of safe-haven jurisdictions, forcefully arguing that content which is illegal or improper in physical form should be treated as such in crypto or online contexts.

Global Regulators Take Tough Stand on AI/ML Controls, Ethics

Following a June consultation, IOSCO today issued guidelines on the use of AI/ML by asset managers and financial intermediaries. Although focused on trading platforms and investment advice, the guidance is sure to influence work under way by the SEC and U.S. banking agencies (see FSM Report **AI**). Global regulators emphasize growing risks in trading platforms and other key functions that require careful management despite AI/ML-derived efficiency gains. They strongly recommend that core national regulators ensure effective corporate governance takes appropriate responsibility for AI/ML regardless of the extent to which systems are obtained from third-party vendors, with due diligence and internal controls addressing outcomes deemed of particular importance. AI/ML application in an "ethical manner" is also cited as a key governance responsibility, with IOSCO focused not only on discrimination, but also the extent to which investors might receive inappropriate or incorrect advice. The latter issue is now being addressed in the SEC's RFI related to brokerage gamification but has not yet been taken up in IOSCO's broader context.

The guidance also outlines standards related to AI/ML testing in baseline and stress scenarios and segregated from business operations unless or until results satisfy compliance and risk-management considerations. Once AI/ML is launched, continuous monitoring would be required, with constant attention paid as data and algorithms evolve also to risks such as market abuse, data privacy, and cybersecurity. Given complexity risks, regulators are told also to consider the benefits of expressly requiring companies to ensure internal staff has sufficient and current AI/ML skill, ensuring that staffing changes do not create model or data risks. Extensive disclosures are also detailed.

Comment Deadline Extended on Third-Party Risk Management Guidance

The federal banking agencies today extended the comment deadline on proposed third-party risk management guidance until October 18. As detailed in FedFin’s in-depth report (see FSM Report **VENDOR9**), these sweeping standards would expand the regulatory perimeter, reaching bank partnerships with fintech, BigTech platforms, and nonbank parent companies in addition to an array of third-party service vendors. While enhancing safety and soundness, the standard could also create new obstacles to innovative product offerings, digitalization, and corporate expansion. Despite being issued as a guidance, violations of the standards could result in significant enforcement penalties.

FHFA Establishes a GSE Equitable-Housing Mission with Major Market Implications

As Karen Petrou's memo this morning forecast, the FHFA has taken strong action today to mandate an equitable-housing plan from Fannie Mae and Freddie Mac above and beyond their existing affordable-housing requirements. The agency is also seeking comment on this construct, which builds on FHFA's new anti-discrimination policy and joint agreement with HUD to enhance fair lending. Although FHFA is an independent agency and thus needs not have done so, the RFI also notes that it has been issued in response to President Biden's racial-equity executive order. The GSEs' plans would need to describe what they have done and/or what they feel needs to be done, with FHFA doubtless comforting some in the industry by emphasizing that all new activities in this arena must be charter-compliant. A forthcoming detailed FedFin analysis will assess what FHFA also proposes to expect of the GSEs and, through them, of lenders, servicers, and credit enhancers. However, our initial review suggests that secondary implications could be significant given FHFA's suggestion that the GSEs require counterparties to undertake fair-lending self-tests, develop new products, and engage in an array of activities the agency believes would advance equitable single- and multi-family housing. Once the plans are finalized, the GSEs would need to issue them for the following three years along with providing annual updates. Comments are due by October 25, with FHFA also hosting a listening session on September 28.

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-090121**: A major paper delivered at last week's Jackson Hole Fed meeting shows – we think conclusively – that it's not demographics that keep interest rates so, so low, but wealth inequality.
- **OVERDRAFT10**: Senior Senate Democrats have proposed legislation that would sharply restrict most transaction-account overdraft fees to the point of likely eliminating them for most consumers at most depository institutions.
- **GREEN10**: House Democrats are considering legislation to mandate a punitive capital construct for bank and, in some cases, also to certain nonbank exposures to companies with fossil-fuel links.
- **GREEN9**: Legislation from House and Senate Democrats would force the Federal Reserve quickly to implement mandatory stress testing for all large banking organizations and large nonbanks judged by asset size if they are principally engaged in finance.
- **GSE-090121**: A major paper delivered at last week's Jackson Hole Fed meeting shows – we think conclusively – that it's not demographics that keep interest rates so, so low, but wealth inequality.
- **GSE-082321**: In this in-depth report, we build on our preliminary analysis of the CFPB's latest HMDA-data assessment. As we noted on Thursday, the agency chose to highlight its totally-unsurprising finding that the mortgage market was hot, hot, hot in 2020.
- **ACCESS3**: Although states and localities continue to ban merchants from refusing to accept cash, federal legislation is also pending to create a nationwide ban on such practices and govern how cash

must be accepted to enhance equality without facilitating money laundering.

- **GSE-081821**: As we anticipated when Sandra Thompson took over, FHFA's newly-proposed approach to the GSEs' affordable-housing goals tackles longstanding criticism that the old measurement criteria promoted gentrification.

- **PREEMPT38**: The chairmen of the Senate Armed Services and Banking Committees, together with many Democratic colleagues, have introduced legislation to extend the interest-rate ceilings in the Military Lending Act (MLA) to all consumers.

- **GSE-081321**: FHFA today released both the 2020 and 2021 stress-test results for Fannie and Freddie.

- **GSE-081121**: As we briefly noted yesterday, the CFPB released a report assessing how the largest servicers handled borrowers over recent, chaotic months.

- **LIBOR6**: The House Financial Services Committee has reported H.R. 4616, a bill designed to prevent the chaos feared when the use of the LIBOR benchmark ceases for legacy contracts that lack language authorizing reliance on an alternative, "fallback" rate.

- **GSE-080421**: A new Fed study finds a significant mark-up in the cost of mortgages during the 2020 boom even though government guarantees secured continued mortgage supply for all but the lowest and highest ends of the housing market.

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