



HFSC Tackles China, CBDC

The committee [memo](#) for the HFSC National Security Subcommittee hearing tomorrow makes it clear that China is the main focus of dollar-sovereignty considerations and CBDC will play a central role in this debate. Legislation to be considered includes a GOP bill to ban CBDC akin to China's – i.e., to make retail CBDC virtually impossible in the U.S. Another bill would bar U.S. persons from using the Chinese CBDC, and we expect the session also to consider matters such as China's efforts to create a SWIFT alternative and other payment-system issues raised at last week's Senate Banking Hearing ([see Client Report CHINA17](#)). We will provide clients with an analysis later on Wednesday.

CFPB Wants Chatbots To Stop Talking

The CFPB today [released](#) an “issue spotlight” looking at how AI in general and chatbots in particular may adversely affect retail-finance consumers, concluding that chatbots may be useful for simple inquiries, but effectiveness wanes as complexity rises. Indeed, some consumers experience “significant negative outcomes” such as “feeling stuck and frustrated,” wasting time, receiving inaccurate answers, and paying more “junk fees.” The report does not clearly differentiate the cost/benefit analysis of these outcomes, with the bureau finding that financial institutions risk legal violations, causing consumer harm, and reputational damage. Chatbots are also found to raise privacy and security risks, some of which again may be legal and others problematic to the consumer experience. Regulators have traditionally thought the level of consumer satisfaction to be a matter for market discipline, not supervisory intervention, but the CFPB has long argued that the shift from relationship banking to services delivered algorithmically poses an array of risks under its purview. The Bureau is thus monitoring the growing use of chatbots, encouraging consumers having difficulty getting human answers to file formal CFPB complaints. Whistleblowers who think chatbots lead to legal violations are also encouraged to contact the Bureau.

Third-Party Guidance Gets Still More Stringent

After repeatedly saying that third-party risk management is a top priority, the banking agencies today [finalized](#) a 2021 proposal ([see FSM Report VENDOR9](#)) tightening current requirements. We will shortly provide clients with an in-depth analysis of the new guidance which, similar to the proposal, will significantly alter the extent to which banks rely on third parties for strategic services and business activities. Indeed, the final guidance is still more stringent, ending the proposed exclusion for “customer relationships,” a change FDIC Director McKernan opposed in his [written statement](#). In conjunction with the Board's 5-1 vote, Gov. Bowman [issued](#) a statement opposing the final standards, noting that the new approach does not suitably tailor standards for smaller banks, which she views as a troubling facet of the Board's growing disregard for proportionality. In contrast, Gov. Waller supports the final guidance, [noting](#) the Board's commitment quickly to engage with community banks to support compliance.

GOP Questions ONRRP, Treasury RWAs

Although HFSC Financial Institutions Subcommittee Chairman Barr (R-KY) today highlighted the legislation on which today's hearing was to [focus](#), much of the discussion over Treasury-management policy revisited last week's debt-ceiling battles. Even so, Rep. Barr raised concerns that the ONRRP takes liquidity out of the economy; witnesses from CRS and the GAO responded only with a promise to review this question. Rep. Barr also asked how the sale of Treasuries at a loss by banks affects systemic safety and soundness; the

witnesses only agreed that interest-rate hikes may increase bank risk. Notably, Rep. Rose (R-TN) suggested that the zero-risk weighting for Treasury obligations may need to be revisited; the witnesses focused in response only on market risk. We have previously noted ([see Client Report REFORM216](#)) that recent risks related to HTM holdings could over time lead to reconsideration of Basel's hard-fought decision to leave sovereign weightings at zero ([see FSM Report CAPITAL220](#)). Highlighting anticipated stronger bank capital requirements and banking system interest rate risk, Rep. Luetkemeyer (R-MO) asked how more treasury issuance might exacerbate bank liquidity problems; the CRS witness only acknowledged that sudden changes in interest rates can lead to economic disruption.

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](#).

- [COMPENSATION36](#): Sen. Warren (D-MA) has introduced a revised version of legislation to ensure that both the FDIC and other federal banking agencies can demand that executives and others governing failed banks refund direct and indirect compensation to the federal government.
- [GSE-060223](#): As we detailed earlier this [week](#), the OCC's new enforcement [policy](#) is a paradigm shift in terms of the legal and reputational risk run by national banks and federal thrifts – that is, by the depository institutions that matter the most to mortgage finance.
- [CHINA17](#): While largely focused on countering fentanyl, today's Senate Banking hearing on China, saw Committee Democrats try to ascertain the details of a potential outbound investment [executive order](#) and Republicans addressing what they believe to be shortcomings in data privacy, AML regulation, and sanctions policy.
- [SUPERVISION2](#): Following a speech earlier this year by the Acting Comptroller arguing that some banks are “too big to manage” and the furor caused by recent failures, the OCC has significantly revised its enforcement policy.
- [GSE-052323](#): Today's HFSC hearing with Sandra Thompson was the anti-LLPA event we [anticipated](#) when it came to Republicans that also saw the stout defense Democrats were sure to provide combined with FHFA's resolute stand on doing nothing to change the LLPAs or guarantee-fees beyond what might come of the pending [RFI](#).
- [REFORM226](#): Describing the CEOs' statements at his last hearing as “the dog-ate-my-homework” excuses for grievous failings, Senate Banking Committee Chairman Brown (D-OH) also attacked Republicans for placing blame on monetary policy, not the culture of supervisory laxity he details with various quotes from Trump Administration officials.
- [CRYPTO44](#): Although there were still considerable party-line differences of opinion on stablecoin legislation, today's HFSC Digital-Assets Subcommittee hearing suggests that remaining divides are narrowing, increasing the odds of a new federal-regulatory framework.
- [GSE-051723](#): With Republicans on the anti-LLPA warpath, FHFA is hoping to preserve as much of the current fee structure as possible without paying too high a political price, issuing a [request for information](#) (RFI) in hopes that letter-writing will keep everyone busy until Congress moves on to other matters.
- [REFORM225](#): A joint hearing today of HFSC's Financial Institutions and Oversight Subcommittees expanded on themes at yesterday's full Committee session with bank regulators ([see Client](#)

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[Report REFORM224](#)) and Senate Banking's session with SVB's and SBNY's [CEOs](#), with First Republic's CEO now added to the Congressional firing line.

- [REFORM224](#): In their first appearance following the reports on recent failures, FRB Vice Chairman Barr and FDIC Chairman Gruenberg were harshly criticized by Republicans for both the bank failures and recommended remedies.
- [DEPOSITINSURANCE120](#): As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic, the FDIC has now proposed a special assessment to compensate the Deposit Insurance Fund (DIF) for the cost of backing the two banks' uninsured deposits.
- [CRYPTO43](#): Today's joint HFSC-House Ag hearing on assessing crypto's regulatory gaps saw bipartisan calls for Congressional action, but none on what that should be done.
- [GSE-050923](#): As [our in-depth report](#) earlier today details, the Fed's latest financial-stability [report](#) pulls a lot of punches because, as always, it's afraid to frighten the children with frank discussion of what might actually threaten financial stability in the near term.
- [SYSTEMIC96](#): Perhaps because its last financial-stability report ([see Client Report SYSTEMIC94](#)) was contradicted just five months later by a systemic-risk designation, the Federal Reserve's latest [report](#) eschews a conclusion about prospective risk in favor of a review of current concerns.