Novel-Activity Supervision

Cite

FRB, SR 23-7, Creation of Novel Activities Supervision Program

Recommended Distribution

Technology, Corporate Development, Audit/Examination, Policy, Legal, Government Relations

Website

https://www.federalreserve.gov/supervisionreg/srletters/SR2307.htm

Impact Assessment

- The Fed has now highlighted several tech arenas as warranting special supervisory attention at banks of all sizes, but whether and how supervision now will differ from what were widely-assumed to be prior attention to new activities is not made clear.
- Novel activities not specifically targeted in this order (e.g., those that led to SVB's failure) appear not to be covered by the new approach.

Overview

FRB Vice Chairman Barr's assessment of SVB's failure included a commitment to pay additional supervisory attention to "novel" activities.[1] New supervisory "information" from the Federal Reserve now acts on this conclusion, creating what is described as a new supervisory program and stating explicitly that the Board will assess certain BHC and state member bank tech-focused activities. The standards by which this is done are not made clear even though all but the stablecoin activities cited here are under way in varying forms at state member banks and BHCs.

Impact

As detailed below, this new supervisory program focuses only on novel activities related to cryptoassets, DLT, and "complex" technology-driven partnerships with nonbanks that deliver financial services. Interestingly, SVB engaged in no activities of this sort except to the indirect degree that it funded or invested in venture-capital entities engaged in such activities; such lending or investment is not considered novel under the terms of this program, which speaks more to the causes of Silvergate's failure[2] as well as Signature Bank's.[3]

1 See *Client Report* **REFORM221**, May 1, 2023.

2 See *Client Report* **CRYPTO38**, January 11, 2023.

3 See *Client Report* **REFORM222**, May 1, 2023.

Consistent with all regulatory statements on technology-driven finance and cryptoassets, the Board's new program begins with a statement recognizing the benefits of innovation to competitiveness and inclusion. That said, the Fed believes novelty includes "manifestations of risk" that warrant additional attention, crafting a program for at least some more or less novel activities it argues will be risk-based in line with input from multi-disciplinary Fed staff and outside experts and academics. Information exchanges will also begin with other federal agencies, industry, and stakeholders. How all this differs from current Fed practice is unclear beyond the special mention now given to the three designated novel activities.

What's Next

The information was released on August 8 without a request for comment. It is effective immediately.

Analysis

A. Scope

The new supervisory program applies to all banking organizations supervised by the Fed, including those with less than $10 billion in assets.

Covered activities include:

- complex, technology-driven partnerships in which banks deliver financial services generated by nonbanks (e.g., APIs);
- cryptoasset activities such as custody, collateralized lending, trading facilitation, and stablecoin/dollar-token issuance or distribution;
- digital ledger technology projects with significant financial-system impact (e.g., dollar or securities tokenization); and
- concentrated banking services to crypto or fintech entities (e.g., payment services).

B. Program

Novel activities will be supervised "in partnership" with the bank's ongoing supervisory group, not a separate team. The Fed emphasizes that this is a risk-based program, with banks coming under novel-activity scrutiny receiving written notice to this effect. Monitoring will also begin on a routine basis for banking organizations considering novel activities – the announcement does not make clear how this will be determined.