FedFin Daily Briefing

Wednesday, September 20, 2023

Brown, Rounds Agree: AI Credit-Underwriting Warrants Regulatory Attention

At today's Senate Banking hearing on AI in financial services, Chairman Brown (D-OH) argued that AI should be governed by the same rules as the rest of the financial system, with new law necessary if existing rules prove inadequate. The Chairman also echoed SEC Chairman Gensler's work on predictive analytics, Fed Vice Chair Barr's concerns about AI algorithmic bias and transparency, and the CFPB's new guidance on AI consumer notices. On the other side, Sen. Rounds (R-SD) criticized the SEC's data analytics proposal on competitiveness grounds, arguing that financial regulators should resist over-regulating emerging technologies. Although Sen. Rounds also defended AI for fraud prevention, he agreed with the Chairman's focus on privacy and transparency as well as the importance of explainability in credit-related decisions. Sens. Menendez (D-NJ) and Warren (D-MA) raised concerns that algorithmic lending bias could expand financial services disparities, particularly in the mortgage market. Melissa Koide of FinRegLab argued for updated AI governance frameworks, while Daniel Gorfine of Gattaca Horizons encouraged regulators to avoid undue focus on AI risk. Michael Wellman of the University of Michigan encouraged regulators to address AI-loopholes and market manipulation.

HFSC FinCEN Bills Draw Bipartisan Support

HFSC Chairman McHenry (R-NC) at today's markup praised the scope of bipartisan support on today's FinCEN, sanctions, and other national security bills. Ranking Member Waters (D-CA) echoed the Chairman's statements but noted that she did not support the CBDC bills which she thought harmed U.S. global financial leadership. The two FinCEN related bills were H.R. 5472 from Rep. Davidson (R-OH) to require Treasury to inform Congress on how it directs FinCEN and H.R 5485 from Rep. Hill (R-AR) to require FinCEN to disclose protocols other government agencies use to access its stored data. Chairman McHenry, Ranking Member Waters, and Rep. Loudermilk (R-GA) voiced support for H.R. 5472, praising the bill for its bipartisan approach and for giving the Committee visibility. Both Chairman McHenry and Ranking Member Waters voiced similar support for H.R. 5485, but Rep. Foster (D-IL) noted that, while he supports the bill, that the Committee should be careful not to impede FinCEN's law enforcement capacity. The Chairman has postponed recorded votes on both bills. We will continue to update clients as the markup progresses.

HFSC Delays Bipartisan Sanction Bill Vote

Today's HFSC markup also considered two bills addressing sanctions policy: H.R. 5512 from Rep. Sherman (D-CA) to require bank subsidiaries to comply with sanctions on Russia and Belarus and H.R. 760 from Rep. Barr (R-KY) imposing blocking sanctions on Chinese defense or surveillance companies and the third-party companies that supply them. Chairman McHenry (R-NC), Ranking Member Waters (D-CA), and Rep. Barr all urged bipartisan support for H.R. 760, with Rep. Barr emphasizing the importance of derisking – but not decoupling – the economy from China. Rep. Sherman noted that H.R. 5512 passed the House as part of last year's NDAA but was taken out by the Senate, urging Members to support the bill again. Both bills recorded votes were also postponed.

HFSC Dems Continue Strongly Opposing GOP Anti-CBDC Measure

The bipartisan spirit of today's HFSC markup dissipated as Members fiercely debated H.R. 5403 from Majority Whip Emmer (R-MN), a bill that would bar the Fed from issuing a CBDC to individuals. Mr.

Emmer reiterated his privacy concerns, stating that a CBDC's potential for financial surveillance posed too great a threat and argued again for a private and digital cash equivalent in its stead. Democrats argued that the GOP's privacy concerns can be addressed in a CBDC's design and are misplaced given that private companies already collect a significant amount of consumer data. They also claimed that halting investigative research forfeits potential innovation. Reps. Steil (R-WI), Barr (R-KY), and other Republicans countered by stating that broader privacy concerns can be addressed by supporting Chair McHenry's data privacy bill that was reported earlier this year and noted that Mr. Emmer's bill does nothing to explicitly prevent research.

Ranking Member Waters (D-CA) submitted an amendment that enshrines a process for Treasury to study Chinese efforts to internationalize the digital Yuan and its impact on the dollar's global status. Rep. Lynch (D-MA) also submitted an amendment that would prevent the bill from being enacted unless Treasury reports that a CBDC cannot be designed with greater data privacy than is afforded by the current framework. Votes for both amendments have been postponed.

Gruenberg: New Shadow Bank Standards Would Cure a Capital Proposal Problem

FDIC Chairman Gruenberg today gave remarks arguing that FSOC along with OFR should establish a new reporting framework to assess the financial stability risks posed by nonbanks and ensure that public reporting is sufficient for market participants to understand nonbank counterparty risk. Although the Chairman supported FSOC's proposed SIFI designation guidance (see FSM Report **SIFI35**) as well as its proposed analytic framework (see FSM Report **SYSTEMIC95**), he called on the Council to develop tailored nonbank prudential regulation and resolution standards. This, Mr. Gruenberg said, would prevent the new capital rules from heightening shadow banking. The Chairman also flagged bank exposures to nonbank CLO holdings, pointing to what he believes are high risk CLO and market interconnections.

HFSC Reports FinCEN, Sanctions, CBDC Bills

HFSC today unanimously reported H.R 760 sanctioning Chinese defense companies, H.R. 5512 requiring bank subsidiaries to comply with sanctions on Russia and Belarus, and H.R. 5472 and 5485 strengthening FinCEN oversight to the House floor. Majority Whip Emmer's (R-MN) anti-CBDC bill, H.R. 5403, did not enjoy the same bipartisan support as it was reported along party lines 27-20. The bill's two amendments – one from Ranking Member Waters (D-CA) enshrining Treasury's ability to study China's CBDC and one from Rep. Lynch (D-MA) preventing the bill from going into effect until Treasury reports that a CBDC cannot be designed with proper data controls – were rejected along partisan lines, also 27-20.

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-092023:** Or maybe it is, but not everyone has heard.
- **LIVINGWILL23:** Although a pending FDIC/FRB proposal imposes a raft of new requirements for resolution plans from IDIs with over $100 billion in assets, the FDIC has also issued a freestanding proposal doing the same, also setting information-filing standards for IDIs below $100 billion but above

$50 billion.

- **CAPITAL235:** With HFSC Chairman McHenry (R-NC) leading the way, GOP Members of the panel's Financial Institutions Subcommittee today blasted the banking agencies' end-game proposal (see *Client Report* **CAPITAL234**).

- **LIVINGWILL22:** In conjunction with proposing a new long-term debt (LTD) requirement for categories II, III, and IV banks, the Fed and FDIC are pursuing other ways to enhance resolvability.

- **TLAC9:** Building on an advance notice of proposed rulemaking, the banking agencies have issued several proposals to enhance the resolvability of large banking organizations not covered by stringent GSIB standards.

- **GSE-083123:** As we noted yesterday, the global banking, securities, and insurance regulators who comprise the Financial Stability Board (FSB) are heading back to look again at securitization to see if the post-08 framework it crafted still works.

- **GSIB22:** As anticipated in the wake of recent bank failures, the FRB has proposed a significant revision to the current rules calculating systemic-risk scores that lead to GSIB designation.

Federal Financial Analytics, Inc.
2101 LStreet, N.W. – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com