FedFin Daily Briefing

Thursday, November 16, 2023

Global Supervisors Press Direct, Indirect CSP Oversight

Global financial supervisors today highlighted cloud-service provider systemic risk, pointing to an issue also of longstanding FSOC concern. The FIS report urges financial regulators to institute cross-border oversight arrangements of critical CSPs, leverage existing regulations from IT and cyber security authorities, and closely coordinate with non-financial authorities. It also recommends additional requirements for critical CSPs where oversight mandates exist as well as strengthened indirect oversight where it does not. Although the report states that the indirect oversight approach remains useful, it also encourages financial authorities to develop direct means to address CSP financial stability concerns. FSOC so far has highlighted the concentrated dependency on a handful of CSPs as an operational and systemic issue (see *Client Report* **FSOC28**). However, with its new systemic methodology (see FSM Report **SYSTEMIC98**) and SIFI-designation process (see FSM Report **SIFI36**), FSOC is now positioned to pursue activity-and-practice designation and is most likely to heed FSI's arguments to go beyond bank-focused limits on CSPs also to subject them to designation, most likely as financial market utilities.

Barr Takes Surprising AOCI Turn

In remarks today focused on Treasury-market risk, FRB Vice Chair Barr also surprisingly said that "most banks" do not need to report unrealized securities gains and losses in capital although supervisors are stepping up surveillance in this area. As noted, one provision in the capital framework (see FSM Report **CAPITAL230**), requires capital recognition of unrealized AFS gains or losses, a move the agencies highlight as a key lesson learned after the March failures. Perhaps Mr. Barr means all but the largest banks in his "most banks" comment, but it is unclear. Mr. Barr also highlighted the agencies' request for comment on sovereign obligation collateral hair-cuts in the pending proposal (see FSM Report **CAPITAL231**), also emphasizing the importance of discount-window preparedness and bank readiness to use other Fed facilities, including the standby repo backstop. Interest-rate risk management also remains a top supervisory concern.

McHenry Escalates FDIC Revelations to Official Probe

Following bipartisan outrage regarding the FDIC's harassment scandal at Senate Banking and HFSC hearings this week, HFSC Chairman McHenry (R-NC) today announced that his Committee will investigate the FDIC as well as Chairman Gruenberg for alleged misconduct. Mr. McHenry notes that this will entail hearings, oversight, and transcribed interviews, and also calls on the FDIC IG to brief HFSC on the matter as soon as possible. Today's announcement also follows HFSC Ranking Member Waters' unsparing criticism yesterday (see *Client Report* **REFORM230**) as well as similar calls from Financial Institutions Subcommittee Ranking Member Foster (D-IL) for a thorough investigation. It is unclear if this controversy led the FDIC earlier today to suspend its public meeting to advance the special-assessment rule, but this seems likely. That rule will now proceed via notation.

Global Regulators Set Crypto Custody Standards

IOSCO today issued final standards for cryptoassets in securities markets, codifying its prior stand that protections such as those against conflicts of interest and embedded vertical-integration risks should be managed for cryptoassets in the same manner regulators and supervisors address them in fiat-asset transactions. The new standards also include a lengthy set of crypto-custody requirements the organization wants applied also to stablecoin reserve assets. While several provisions track requirements in the SEC's controversial custody proposal (see FSM Report **CUSTODY5**), IOSCO does not go as far as SAB 121 and also require custody-asset consolidation into the custodian's own balance sheet. Custody assets are, though, required to be carefully segregated into bankruptcy-remote or similar accounts subject to extensive monitoring and reporting requirements. Unlike the SEC, the global standards also do not expressly require an independent custodian, but regulators are told to impose additional requirements if these are not provided. The new standards are effective although they will have no practical impact or until nations act on them.

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-111623**: As our reports on the Senate and House hearings with bank regulators made clear, our prediction that the agencies would compromise on mortgage risk-based capital requirements will prove itself in the final standards.

- **REFORM230**: Following yesterday's Senate Banking hearing (see *Client Report* **REFORM229**), today's HFSC session with top bank regulators again highlighted growing bipartisan consternation over the unintended consequences of the agencies' capital proposal (see FSM Report **CAPITAL230**).

- **PAYMENT27**: Building on its director's longstanding focus on fintech and tech-platform companies, the CFPB has proposed to extend its supervisory reach to nonbank providers of general-use digital payments services.

- **REFORM229**: Today's Senate Banking hearing with top bank regulators showcased broad bipartisan concern over the interagency capital proposal (see FSM Report **CAPITAL230**).

- **SIFI37**: In concert with finalizing a new systemic-risk methodology, the Financial Stability Oversight Council issued guidance that significantly rewrites the manner in which nonbanks are designated as systemically important financial institutions (SIFIs), largely retaining its initial proposal.

- **SYSTEMIC98**: Rejecting the Trump Administration's hands-off approach to designating systemically-important nonbank financial institutions or activities and practices, the Biden Administration's FSOC has finalized its bifurcated proposals to designate systemic entities and another laying out an analytical approach to identifying systemic risk that would then guide firm and activity designation as well as Council staff coordination with primary federal regulators.

- **GSE-110823**: Although FHFA calls its FHLB report a centenary event ahead of the System's 2032 birthday, the agency clearly plans structural substantive reform well before that milestone.

- **CLIMATE17**: The banking agencies have joined together to issue inter-agency climate-risk guidance based on proposed standards from the FDIC, OCC and FRB.

- **INTERCHANGE12**: As suggested when the Fed last year finalized controversial new debit-card routing requirements, the central bank is now proposing a sharp reduction in the cap mandated on debit-card interchange fees under the Dodd-Frank Act's Durbin Amendment for debit-card issuers with over $10 billion in assets.

- **AI3**: In this report, we assess the detailed executive order (EO) issued late Monday afternoon after days of private showings of selected versions.

- **DATA4**: Following a request for information that was a de facto advance notice of proposed rulemaking, the CFPB has now proposed a preliminary, but binding framework for consumer data rights covering consumer "transaction" accounts offered by banks, credit unions, and – a departure from the initial outline – nonbanks/fintechs.

- **GSE-102323**: As noted in our report earlier today, the Federal Reserve's latest financial-stability report expresses deep misgivings about complex securitizations.

- **SYSTEMIC97**: As promised, this in-depth report assesses Friday's semiannual financial-stability report from the Federal Reserve.

- **DEPOSITINSURANCE122**: Bipartisan senators have introduced legislation to provide FDIC coverage for certain noninterest-bearing transaction accounts, a move designed to prevent the stress and potential systemic risk evident when Silicon Valley and Signature Banks failed in March.

- **GSE-101723**: As we noted earlier this month, the Federal Reserve inserted a significant capital provision for credit-linked notes in an otherwise-obscure FAQ.