FedFin Daily Briefing

Wednesday, December 14, 2023

Top Senate Democrats Heighten Payment App Scrutiny

Continuing to shift their focus from Zelle to payment-service providers, Senate Banking Chairman Brown (D-OH) along with Sens. Reed (D-RI) and Warren (D-MA) today sent letters to Paypal and CashApp urging them to adopt new scam-reimbursement policies. The letter follows one earlier this summer to the providers and a sweeping effort by the CFPB to govern this sector (see FSM Report **PAYMENT27**). Noting Zelle's recent steps to reimburse victims of imposter scams, the senators call on the companies to follow suit. They also urge Venmo to facilitate consumer reporting of fraudulently-induced transactions and CashApp to revise its approach to categorizing authorized and unauthorized transactions. Detailed information on the companies' fraud detection practices, consumer arbitration processes, and reasoning for blocking accounts rather than users is requested by January 31.

Treasury Defends Russian Sanctions, Economic-Warfare Clout

Facing increasing assertions that U.S.-led sanctions are not meaningfully affecting Russia, Treasury today issued a blog stoutly defending sanctions effectiveness. Treasury lays out how Russia is sacrificing long-term growth and economic stability with stop-gap sanctions work-arounds, although neither the two percent drop in 2022 household consumption nor the discussion of Russian volatility to demand shocks may persuade critics that sanctions have meaningfully dented Russia's military might as intended. Perhaps anticipating this, Treasury also suggests that sanctions imposed last month will materially affect Russia's military supply chain. The sharp increase in emigration and resulting loss of human capital is also cited as a sanctions win although some might attribute it at least in part to fear of military service or the high risk of political dissent.

Reed Presses OFR to Subpoena Shadow-Bank Data

The principal sponsor of the Dodd-Frank provisions creating the Office of Financial Research, Sen. Jack Reed (D-RI), today defended the agency on grounds that it lacks a confirmed director, promising to push the appointment on the floor as quickly as possible. Reiterating complaints about credit-linked notes (See *Client Report* **REFORM229**), Sen. Reed more broadly attacked shadow banking, noting the lack of data on this sector combined with its increasing risk due in part to these instruments. He thus urged OFR to use its subpoena power to evaluate emerging risks. Sen. Reed is also a strong supporter of the legal entity identifier (LEI), suggesting today that the slow pace of adoption in the U.S. enhances the likelihood of sanctions evasion.

Basel Targets Stablecoin Reserve-Asset Risk

Moving forward with "targeted" changes to current standards, the Basel Committee today outlined revisions to its crypto standards with significant practical implications. The proposal rewrites the way capital rules would work in relation to crypto risk (see FSM Report **CRYPTO37**), tightening the criteria for reserve assets necessary for a stablecoin issuer to secure a preferential weighting. The U.S. has yet to act on the initial proposal, deferring this until broader end-game standards advance and Congress either enacts stablecoin legislation or leaves risk management to regulators. We will shortly provide clients with an in-depth analysis; comments are due by March 28.

Liang Disputes Over-Arching Need for New AI Regs

Treasury Under Secretary Liang today argued that AI is not fundamentally different than other financial innovations and is already subject to existing consumer-protection, safety-and-soundness, illicit-finance, and financial-stability guardrails. Nonetheless, Ms. Liang noted AI's similarities to CCPs, stating that AI's key financial sector risks are cybersecurity-related and that Treasury is thus already focused on the issue. Regulators will consider doing still more to target AI should the technology expose other gaps. In addition, the Under Secretary lauded "night and day" differences in today's data quality compared to data available during the GFC. She was also emphatic that March banking turmoil did not stem from data insufficiency, arguing that uninsured deposits and IRR data were publicly available and part of the reason for the "forceful" regulatory response to the crisis.

FRB-NY Official Highlights AI Promise, Problems, Policy Action

Summarizing a recent Federal Reserve Bank of New York AI conference, the Bank's chief risk officer, Mihaela Nistor, concluded that AI can now identify GSIB and GSIFI risk due to its ability to detect tail behavior not now captured by relevant models. AI may also prove effective identifying risky links between digital assets and the traditional financial system, with AI's role already clear when it comes to reducing risk specific to digital assets and the blockchain. That said, AI poses an array of challenges requiring further regulatory and policy-maker attention in areas such as safety and soundness and national security. Hard work is also needed on AI's ethical implications, with Ms. Nistor calling for industry groups addressing these concerns. Notably, the Biden Administration today announced a group akin to this for private-sector health providers deploying AI to ensure equity, transparency, and sound innovation.

Democrats Urge CFPB to Take Second Stand Against Forced Arbitration

Sens. Warren (D-MA) and Sanders (I-VT) were today joined by over 90 other Democratic lawmakers in sending a letter to CFPB Director Chopra urging the Bureau to issue a new rule to set strict standards for forced arbitration agreements in financial products and services. There is a considerable history of CFPB actions following requests in letters such as this. It argues that the CFPB is statutorily permitted to propose a new rule as long as it is not in substantially the same form as the rule overturned via the CRA in 2017. The lawmakers also urge other federal agencies to curtail what they call corporations' "fine print traps." No response is requested.

Waters Tries to Protect Banking Agencies on Workplace Practice

Responding to her request at a recent hearing (see *Client Report* **REFORM230**), HFSC Ranking Member Waters (D-CA) today indicated that all of the banking agencies have sent her their current policies against sexual harassment. These may now be found at the bottom of her press release. However, they are most unlikely to quell demands from Republicans to hear from the FDIC and now also the OCC and FRB not only about their policies in this area, but also broader workplace practices and why recent incidents do not demonstrate the agencies' overall inability to undertake credible regulation and supervision.

FSOC Tackles AI, Reiterates Prior Climate/Cyber Priorities

As anticipated, FSOC today unanimously approved its annual report; FedFin will shortly provide clients with an in-depth analysis. Key to its conclusions were the new focus on AI emphasized by Secretary Yellen and echoed by SEC Chair Gensler. CFPB Director Chopra supported this approach, but emphasized the need to quickly deploy FSOC's new systemic methodology (see FSM Report **SYSTEMIC95**) to ensure that designation does not become a "dead letter." He also pressed for systemic review of big tech given what he believes to be dangerous network effects. The Council also again noted climate and cyber risks as continuing concerns, with Ms. Yellen also congratulating the banking agencies for their handling of the March failures.

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- **GSE-121423**: In a blog post today, Fannie quietly renews its quest for alternatives to traditional title insurance.
- **GSIB23**: The agencies' capital proposal (see FSM Report **CAPITAL230**) unsurprisingly dominated discussion at today's Senate Banking hearing with big bank CEOs.
- **FINTECH33**: At today's HFSC Digital Assets Subcommittee hearing on banking agency financial innovation, Republicans raised concerns about the Fed's novel activities guidance (see FSM Report **FINTECH32**), interagency guidance on third-party risk management (see FSM Report **VENDOR10**), and the SEC's predictive data analytics proposal.
- **CONSUMER54**: Today's Senate Banking hearing with Director Chopra was even more cordial than yesterday's HFSC session (see *Client Report* **CONSUMER53**) even though Republicans continued to criticize the Bureau's recent rulemakings.
- **GSE-113023**: A new FRB-NY study confirms that 83% of loans from 2000-2022 went to first-time homebuyers, compared to 56% for the GSEs and 57% for private lenders.
- **CONSUMER53**: In sharp contrast to most recent HFSC hearings with CFPB Director Chopra, today's session was relatively calm.
- **GSE-112723**: The most significant thing in FHFA's final capital rule is not what is to be done, but what FHFA left out: ending the GSEs' advanced-approach requirement.
- **DEPOSITINSURANCE122**: As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic, the FDIC has finalized its proposed approach to imposing a systemic assessment to reimburse the Deposit Insurance Fund (DIF) for the resolution costs related to uninsured deposits following a systemic designation.
- **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.

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