FedFin Daily Briefing

Monday, January 29, 2024

White House Advances AI Governance, Government Adoption

Following the President's AI executive order (see *Client Report* **AI3**), the White House today released an update following a steering-group meeting. The order demanded action on the President's AI orders, including those addressing innovation within the government and heightened AI risk of key providers and technologies. The fact sheet at this deadline lays out numerous pilot projects and other actions that begin to craft U.S. policy in the absence of pending legislation. Work is already advancing on hiring AI talent for the federal government, assisting educators, and limiting bias in health- and drug-development related AI applications. The fact sheet does not address financial-policy questions. All relevant agencies but the CFPB are independent and thus not compelled to act. However, as we noted last week, the CFTC has led this group with a new request for comment on AI not only in its derivatives-regulatory sphere, but also across the financial system. We will shortly provide clients with an in-depth analysis of this request. The SEC is also well underway on Chair Gensler's longstanding campaign to govern predictive analytics, including AI. The CFPB has incorporated AI policy in its longstanding standards for digital marketing (see FSM Report **FINTECH30**), also planning new work on AI bias and transparency.

BIS Study Examines Stablecoin Run-Risk

A new BIS study supports pending U.S. legislation and possible rules related to stablecoin reserve assets and run-risk, finding that transparency increases stablecoin stability when reserve assets are of high quality, but decreases stability when reserves are perceived to be low quality or when there are low transaction costs to convert to fiat. Stablecoins with high-risk reserve assets are stable under minimal stress, but par convertibility collapses under large negative shocks. The paper utilizes a global games framework to model stablecoin issuer and holder interactions, noting that unnamed recent developments in the US banking and regulatory landscape may yield further insight into the relationship between transparency, collateral quality, and stablecoin risk.

Hsu Sets Course to New OCC Merger Policy with No Fed Companion in Sight

In remarks today emphasizing the need for a more transparent bank-merger process, Acting Comptroller Hsu announced that the OCC will today release an NPR eliminating the possibility that merger applications will be approved solely by the passage of time. The policy revision will also explore the extent to which data beyond deposit share should be deployed in the manner suggested last year by Assistant Attorney General Kanter. Notably, unless or until the FRB joins in the merger-policy review, any new approaches adopted by the OCC may have no ultimate impact on deal consummation whenever a holding company is involved and DOJ approves. We will soon provide clients with an in-depth report of the proposal, which Mr. Hsu noted also includes a policy statement clearly identifying the features of merger applications or indicators that will be generally consistent with OCC approval as well as those that raise supervisory concerns leading to disapproval. In conjunction with the proposal, the OCC will later this year also publish data on bank mergers subject to OCC review. The data will include CRA ratings, asset size, applicant info, target bank info, and OCC action on each filing. In addition, the OCC will issue a report featuring a literature review of bank mergers and consolidation research that identifies key outstanding questions. Following his speech, Mr. Hsu invited comment on whether the OCC's proposal is overly prescriptive or needs to be more specific regarding convenience and needs analysis. He also emphasized that the financial-stability prong of merger analysis should be updated to ensure that all large banks are resolvable without government support. Mr.

Hsu rebuffed criticism of the JPM/FRC merger last year, but reiterated the 2022 call by the FDIC in a request for comment (see FSM Report **RESOLVE48**) that the least-cost test should be updated.

Warren Starts the New Year with Political Pressure on Fed Policy

Reiterating concerns about high interest rates, Sen. Warren (D-MA) along with Sens. Hickenlooper (D-CO), Rosen (D-NV) and Whitehouse (D-RI) today sent a letter to Chair Powell calling on him to reverse rate hikes, citing its impact on the current affordable housing crisis. The letter is sure to heighten political pressure on the FRB, which as Karen Petrou recently noted will be pushed and pulled throughout this election year regardless of how objective Mr. Powell will surely assert its decisions remain. The senators praise the FOMC's decision to pause rate hikes as a "welcome first step" but state that interest rates remain too high due to their adverse impact on affordable housing. No questions are posed and no deadline is set for a reply.

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.

- **CONSUMER55:** The CFPB has followed up a controversial proposal to set prices for larger-bank overdrafts exempt from certain consumer standards with a proposal to simply ban certain non-sufficient fund (NSF) fees when banks decide in real time to decline a consumer-payment request.
- **GSE-012424:** In this report, we build on our previous analyses of the mortgage implications of the pending capital rules, forecasting what's next for mortgage assets as the FRB, FDIC, and OCC wrestle with the mess Karen Petrou has elsewhere argued they brought upon themselves by careless analytics and political misjudgment.
- **OVERDRAFT12:** Building on a bulletin and circular from late 2022 warning banks about certain overdraft practices, the CFPB has now proposed a rule that would sharply and expressly limit fees for extensions of credit related to overdrawn transaction accounts unless the account comes under an array of consumer-protection requirements.
- **GSE-012224:** A new Fed staff study uses models to conclude that government-backed mortgage securitization exacerbates financial crises, contradicting conventional wisdom that – GSE blow-ups notwithstanding – properly-regulated GSEs create a liquid, diversified asset pool for an otherwise illiquid, risky asset class.
- **GSE-011224**: A new staff paper from the Federal Reserve Bank of New York assesses the tender topic of bank mortgage lending to minority borrowers.
- **GSE-010924:** Based on recent dialogue with institutional investors and regulators, a new FRB-NY Teller Window article concludes that robust data collection, loan standardization, and higher volume could improve CDFI secondary market sales.
- **GSE-010824:** It's not news to observe that things that change at the GSEs then change a lot of other things.
- **INCLUSION3:** As required by law, the U.S. Treasury is working to set policy enhancing financial inclusion.
- **NBFI3:** The banking agencies have proposed significant changes to call-reporting data illuminating how banking organizations are inter-connected with nonbank financial intermediaries and to implement

pending requirements for long-term debt (LTD) issuance.

- **DEPOSITINSURANCE123:** In the wake of increasing instances in which customers are confused and even misled about the extent to which fintech and cryptoasset holdings are insured deposits, the FDIC has finalized its proposal setting disclosure standards as well as modernizing IDI representations of their own FDIC-insured offerings in branches and through the fast-changing array of retail banking delivery channels.

- **GSE-010224:** Shortly before the new year, the banking agencies proposed new call-report requirements that would force banks with over $10 billion in assets to report new data on nonbank mortgage intermediaries and structured GSE-guaranteed positions.

- **AI4:** Bipartisan Senate legislation has been introduced to press FSOC to do more than highlight artificial intelligence (AI) as a potential threat to financial stability.

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