Bank Regulation in 2022: A Full Agenda, with Cryptoassets in Focus

There are many important regulatory policy issues that will be considered in the U.S. banking sector during 2022, including those regarding climate-related financial risk (see our overview here), regulatory review of mergers and acquisitions (see our analysis here)[1] and consumer data sharing (see our outline of key issues here). Regulatory approaches to cryptoassets, however, appear to have been first among equals in the last half of 2021. Moreover, the rapid development of the market is pressuring regulatory action in the area and, at the same time, there appears to be a reasonable degree of consensus in the regulatory community that clearer rules of the road are needed. For these reasons, we think the bank regulatory approach to cryptoassets will be front and center in 2022.

As we have said before, we believe that ultimately nonbank actors will face additional regulation and banks will have more clarity about how and under what conditions they may engage in cryptoasset activities. Where those lines are drawn will have competitive implications for years to come.

Below, we review key cryptoasset-related developments from the end of 2021 and offer thoughts on what lies ahead in 2022.

End of 2021 Developments

- In early November, the President's Working Group on Financial Markets ("PWG"), along with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency ("OCC"), issued recommendations regarding the regulation of stablecoins (see our prior analysis here).
    - The report recommended that Congress promptly pass legislation requiring stablecoin issuers to be insured depository institutions and to provide federal authorities with oversight over custodial wallet providers and other key participants in stablecoin arrangements.
    - In the absence of congressional action, the report recommended certain regulatory actions, including that the Financial Stability Oversight Council ("FSOC") pursue its authority to designate certain activities within stablecoin arrangements as systemically important payment, clearing and settlement ("PCS") activities.
- In December, the Senate Banking Committee held a hearing on stablecoin issues and, in connection with that hearing, Senator Pat Toomey (R-Pa), the committee's ranking member, issued principles that he believes should motivate legislation and regulation regarding stablecoin issues. He also said he was open to working with the Biden administration and his Democratic colleagues on legislation.
- Also in December, the FSOC released its annual report, which noted that the FSOC will be "prepared to consider steps available to it to address risks outlined" in the PWG report "in the event comprehensive legislation is not enacted". The report does not provide a timeline for when the FSOC will consider such steps or explain what it considers to constitute "comprehensive" legislation.

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[1] As noted in our analysis, some statutory factors for M&A proposals are likely to receive new emphasis. One factor that is expected to receive significant additional attention relates to the requirement that the regulators consider the increased risk to U.S. financial stability that an M&A transaction may pose. The agencies could, for example, revise how they analyze financial stability risk in the M&A context. In doing so, the agencies will need to strike a careful balance. For example, a revised financial stability analysis that has the effect of prohibiting a materially greater amount of M&A transactions could be seen as a criticism of the banking regulators' current supervision and regulation of financial stability risks. Banking regulators have spent over a decade standing up a regulatory regime that is intended to address financial stability risk, including risk posed by the largest banking organizations in the world. Except for extreme cases, denying M&A transactions based on financial stability risk while defending the financial stability regulation of existing institutions would appear to be two inconsistent, and potentially untenable, positions. Therefore, the agencies may be more likely to modify the financial stability consideration to allow for any financial stability concerns to be addressed without denial of the transaction (*e.g.*, through commitments of the applicant).

- At the international level, the Committee on Payments and Market Infrastructure ("CPMI") and the Board of the International Organization of Securities Commissions ("IOSCO") proposed guidance on the application of the *Principles for financial market infrastructures* ("PFMI") to systemically important stablecoin arrangements. The CPMI and IOSCO's approach to apply the PFMI to such stablecoin arrangements will be important, as it may indicate how the FSOC and other regulators would be inclined to treat stablecoin activities under the regulatory framework that ultimately emerges in the United States.

- A broad-based group of trade associations submitted comments to the Basel Committee on Banking Supervision's ("BCBS") consultation on the prudential treatment of cryptoasset exposures. The trade associations noted that banking organizations, at present, have limited exposure to cryptoasset markets, which "is neither desirable nor sustainable" in the longer term. The trade associations urged the development of a prudential framework that does not preclude banking organization involvement in cryptoasset markets. The BCBS has noted that it anticipates issuing another consultation on the topic in mid-2022.

- The federal banking agencies issued a two-page statement on the next steps in their cryptoasset initiative. That statement sets out topics that the federal banking agencies will consider in 2022, which includes most topics relevant for banking organization involvement in cryptoasset markets. The statement also notes that the agencies will evaluate the application of bank capital and liquidity standards to cryptoassets for activities involving U.S. banking organizations and will continue to engage with the BCBS on its consultative process in this area.

- The OCC released guidance clarifying its approach to cryptoasset-related activities (see our prior analysis here). The bottom line of that guidance is that OCC-regulated firms will need to seek prior approval to engage in cryptoasset-related activities. State regulators very well may follow this same approach.

- Taking on a broader range of issues, Acting Comptroller of the Currency Michael J. Hsu gave a speech in November, arguing that additional regulation is needed for "synthetic banking providers" as well as "large, universal crypto firms—especially issuers of highly-circulated stablecoins".

Early 2022 Outlook

As the policy processes regarding these issues progress, we will be watching the following points.

- Senator Toomey's principles regarding stablecoin regulation, in our view, appear to illustrate a willingness to engage in good-faith discussions with Democrats on Capitol Hill and the Biden administration to find common ground for legislation. Although the prospect of legislation is uncertain, particularly in the current political environment and during an election year, we will be watching closely whether discussions commence and advance. From a policy perspective alone, there should be room for agreement. But, of course, there will be political elements to the debate separate and apart from the substance.

- At the same time, we expect the FSOC will begin taking public-facing steps regarding the PWG's recommendations. These steps could include seeking preliminary input from the public regarding stablecoin arrangements or announcing the formation of a working group to evaluate potential PCS activity designation. Those initial steps may indicate how much work the FSOC staff has done to date and, based on that, how quickly the PCS designation process could conclude (*i.e.*, if it is clear that the staff work is advanced, the PCS designation process could move forward promptly). We expect that the amount and tenor of the FSOC's public actions in this space will be inversely correlated to Congress's—that is, the FSOC essentially will seek to pick up Congress's slack if it perceives congressional action to be unlikely or unduly slowed.

- We also will be watching whether the Securities and Exchange Commission indicates regulatory interest in certain stablecoins (for example, fiat-pegged, non-interest-paying stablecoins) or, alternatively, effectively cedes authority to the bank regulators on those products by focusing its efforts on other segments of the cryptoasset market.

- Regarding the federal banking agencies' cryptoasset initiatives, the agencies' joint "sprint" in 2021 should have helped them develop a common understanding of the basic facts and issues to be addressed, which we hope will expedite appropriate and consistent regulatory action in 2022. However, the type of actions taken may vary in a number of respects. For example, the agencies may seek to act jointly with respect to certain issues (*e.g.*, capital requirements) and individually with respect to others (*e.g.*, permissibility). Similarly, some actions may be more appropriate for notice and comment while others could be taken through interpretive letter or supervisory guidance that is immediately effective. Moreover, agencies may be more likely to take action with respect to activities in which banks are actively engaging or have requested authority to engage. These factors are likely to affect the timing of agency action and possibly affect the substantive outcome.

- Although the BCBS plans to issue a consultation in mid-2022 regarding the capital treatment of cryptoasset exposures, the federal banking agencies statement on their cryptoasset initiative may indicate a willingness to provide guidance to U.S. banking organizations on the appropriate capital treatment prior to the conclusion of the BCBS process. We will be watching closely to see whether the agencies provide further indications in this regard.

- The Federal Reserve's forthcoming "future of money" white paper may indicate whether the Federal Reserve's views are fully aligned with the other members of the PWG stablecoin working group. For example, if the white paper takes different or more detailed positions than the PWG report, that may provide insight into the views the Federal Reserve brings to interagency discussions. Potential areas for elaboration include the type of prudential standards the Federal Reserve believes appropriate for stablecoin arrangements and whether it believes stablecoin issuance should be limited to insured depository institutions.

- Another issue that we will be watching is whether the Federal Reserve, through the future of money white paper or other means, provides any indication about how the Federal Reserve is considering addressing requests for Federal Reserve Bank master accounts by state-charted cryptoasset-focused banks and trust companies and other banks with novel business models, or how the Federal Reserve may address master accounts for any stablecoin issuer after a federal regulatory framework is in place.

- As noted above, Acting Comptroller of the Currency Hsu suggested additional regulation is needed for "synthetic banking providers" and "large, universal crypto firms". It was not entirely clear what authorities the Acting Comptroller thought could be used to promulgate such regulation, so we will be watching whether the OCC or other banking agencies seek public comment or otherwise indicate a focus on addressing the concerns the Acting Comptroller raised.

As we noted at the outset, the agencies also will commit resources to address a wide range of issues. In addition to the issues we noted above, the agencies may also address the Basel III end game capital standards (including the role of the leverage ratio) and Treasury market reform. As a practical matter, we do not think the agencies will be able to address fully all of these issues. That said, we believe that cryptoasset issues will remain at the fore, in part because of the intense acceleration of market growth and demand. And, as we previously noted, the competitive implications are acute.