Future of Banking: Key Policy Making on the Horizon

During the dog days of summer, the financial regulatory policy making world was busy laying the ground work for key decisions and processes that will be critical for determining how innovation and technology will be integrated into the banking sector. The policy process is likely to take some time but, ultimately, conclude with more regulation of nonbank actors and more clarity about how and under what conditions banks may engage in digital asset activities. Where those lines will be drawn, however, remains up in the air. And the outcome will have implications for the competitive landscape for years to come. Below we review the key developments from the summer and offer our thoughts on the months ahead (see here for a slide deck reviewing the legal and policy issues in more detail).

- After the federal banking agencies took a go-it-alone and somewhat ad hoc approach to innovation issues, the agencies formed interagency "sprint" teams to coordinate policy making on digital asset and related issues.[1] It is not yet clear what the sprint teams' work product will be, although we know that the teams are to (1) develop a common taxonomy for digital assets; (2) define use cases and related risks for digital assets; (3) identify potential regulatory gaps; and (4) consider policy needs in light of the other teams' findings.

- The President's Working Group on Financial Markets ("PWG") announced that staff is preparing a report on stablecoins. The report will cover potential benefits and risks, the current U.S. regulatory framework and recommendations for addressing any regulatory gaps.

- The Federal Reserve Board ("FRB") is preparing a white paper, anticipated to be released this month or next, that will cover a range of digital-asset issues including issues related to stablecoins, other cryptoassets and central bank digital currencies ("CBDCs"). See here for a slide showing the varied views on CBDCs at the FRB.

- The Basel Committee on Banking Supervision ("Basel Committee") made its first big step towards establishing global standards for capital and other prudential requirements for cryptoassets.

- Meanwhile, prominent and influential commenters have proposed regulatory approaches for regulating stablecoins (see here and here) and comprehensive legislation to clarify the regulation of digital assets more broadly was introduced in the House of Representatives (see here).

- The FRB began reviewing the numerous comments to its proposed guidelines for evaluating requests for master accounts at Reserve Banks. These guidelines would govern requests by fintechs that have special purpose bank charters, narrow banks and others for a master account that provides access to the Federal Reserve payment system.

- Acting Comptroller Hsu announced the Office of the Comptroller of the Currency ("OCC") is reviewing previous policy decisions of the OCC with respect to digital asset activities and national bank charters for fintech firms.

- Securities and Exchange Commission ("SEC") Chair Gary Gensler gave a speech laying out an expansive view of the SEC's jurisdictional authority over digital asset issues (he said the SEC will take its "authorities as far as they go").

[1] *See*, *e.g.*, Statement of Michael Hsu, Acting Comptroller of the Currency, p. 12 (Aug. 3, 2021).

In light of these developments, we believe the following points will be important to watch in the months ahead.

- The international policy making process at the Basel Committee will be iterative and the consultation from this summer shows a very preliminary understanding, and skepticism, of cryptoasset markets.
- As a result of the preliminary nature of the Basel Committee's work, the U.S. policy processes described below will have the ability to influence the global standard setting process going forward.
  - *FRB whitepaper*: The FRB's whitepaper is not expected to take a position on whether the United States should issue a CBDC, but it is likely to clarify the agency's views on the benefits and risks of stablecoins and could go further (*e.g.*, signal how the FRB will approach permissibility and capital treatment).
  - *Interagency sprint teams*: Although any public work product of the interagency sprint teams is unlikely to propose new policy, it may be helpful in revealing the extent to which the banking agencies (1) understand digital asset markets, (2) have biases regarding banking organization involvement in such markets and (3) are in agreement on key issues.
  - *PWG working group report*: Compared to other reports expected this fall, the PWG report requires the most interagency coordination across banking and market regulators and, therefore, may be most subject to delays, internal inconsistencies, and a lack of clarity on key issues. We do, however, expect the report to clearly advocate for additional regulation of stablecoins.
  - *OCC prior policy review*: We believe it is unlikely the OCC will completely cede chartering of fintech and other innovative firms to state banking regulators. Thus, there likely will be some path available for fintech chartering once the OCC concludes its policy review, but that path likely will be narrower than the path envisioned by the OCC under former Acting Comptroller Brooks and may not be attractive to the firms that previously sought federal charters.
  - *Federal Reserve payment system access*: Even if the OCC and state regulators continue to grant fintech charters, the Federal Reserve is likely to take a cautious approach to providing access to its payment system, particularly unless and until there is a more robust regulatory framework for the digital asset activities conducted by firms that previously have obtained or sought charters.
- Interagency coordination (and lack thereof) is key.
  - Given the complexity of the subject matter and the different perspectives of the various agencies, substantive disagreements among the agencies will arise. Typically, that disagreement can substantially slow down a policy process. Recall that the interagency process to write Volcker Rule regulations took about three years (plus over five more years of interpretations and rewriting of rules). Similarly, the interagency process to write executive compensation rules is still pending, eleven-plus years after that mandate was included in the Dodd-Frank Act.
  - In this case, however, the interagency dynamic may differ from prior situations for a couple reasons. The banking agencies (in particular the FRB and OCC) and the Treasury Department are likely to be even more closely aligned than normal, given the strong overlap of FRB alums across key positions at the OCC and Treasury Department. That alignment may mitigate an otherwise muscular leadership at the SEC.
  - The timing and substance of the expected reports by the FRB, PWG and interagency sprint teams, and the OCC's policy review should reveal how well agencies are aligned on key issues, including with respect to questions of what issues fall within the jurisdiction of each agency.

- Likewise, delays of a report or differences among reports may help identify fault lines between the agencies. For example, to the extent there is disagreement among the banking agencies and the Treasury Department, on the one hand, and the SEC, on the other, those might be revealed in any differences in the PWG report (which should include SEC involvement) and the other work of the banking agencies and Treasury Department that does not necessarily include the SEC.

- Other items we continue to watch:
  - Whether and how the Federal Deposit Insurance Corporation will process and evaluate deposit insurance applications for industrial banks under the new composition of its Board of Directors and if that will change once the heads of the Consumer Financial Protection Bureau and OCC are confirmed by the Senate.
  - Whether and the extent to which the Financial Stability Oversight Council ("FSOC") becomes involved in digital asset issues, either in place of or in addition to the PWG. We continue to believe that the FSOC's authority under Title VIII of the Dodd-Frank Act remains a viable route to regulating stablecoin activities, particularly in the absence of legislation to clarify the regulatory landscape.

As always, the agencies have a full agenda of policy issues to tackle, including climate-related issues (see here for our summary of developments), finalizing the implementation of international capital accords in the United States and Treasury market reform, just to name a few. The innovation agenda, however, accelerated meaningfully over the summer, driven by markets, customer demand for digital assets and a heightened awareness of the regulatory gaps and of competitive implications for the banking sector. The policy decisions around innovation issues will shape and shift the competitive landscape in the financial services sector for many years to come and, we believe, the policy junctures described above will be critical to understanding (and influencing) that shift.