

NY Banking Brief: All The Notable Compliance Updates In Q2

By **Will Giles** (July 13, 2023)

In this Expert Analysis series, attorneys provide quarterly recaps discussing the biggest developments in New York banking regulation and policymaking.

The second quarter of 2023 was a busy quarter for legislative and regulatory developments in New York financial services law.

New York policymakers and regulators focused on taking initial steps to advance changes to the state's regulatory and supervisory framework for New York banks in response to the sudden failure of Signature Bank. They also continued their efforts to keep New York at the forefront of digital asset industry regulation.



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We discuss these and other significant developments below.

Results of the Review of the Supervision and Closure of Signature Bank

In April, the New York State Department of Financial Services released its review of the supervisory process and events leading to the March 12 closure of Signature Bank.[1]

The report cited a number of factors contributing to the bank's failure, including its accelerated growth between 2019 and 2021 — which outpaced the development of its risk control framework — failure to remediate identified liquidity management issues, high concentration of uninsured deposits and perceived similarities with banks that had recently failed or begun liquidation.[2]

The internal review also identified a number of specific improvements to the NYDFS bank supervisory process in light of the events. Among other things, the report recommended that the NYDFS:

- Update its policies and procedures to reduce inefficiencies in issuing examination findings and ensure that risks at banking organizations are addressed in real time;
- Rebuild its examination capacity with a larger pool of examiners and supervisors to close the timing gap between the end of examinations and the issuance of reports of examination and supervisory letters;
- Consider whether banks need to conduct tabletop exercises to demonstrate operational readiness to collect and produce accurate financial data at a rapid pace and in a stress scenario;

- Adopt clearer guidelines in its internal processes for when examiners need to escalate regulatory concerns or when a bank fails to remediate findings in a timely fashion, including establishing clear escalation procedures to address repeat regulatory findings;
- Revisit the assumptions used to model and manage liquidity risk, including considering recent depositor behavior against the assumptions used in the liquidity coverage ratio and more generally with respect to the classification of so-called stable deposits; and
- Develop regulatory tools to (1) hold executives accountable for misconduct that leads to the failure of a banking organization and (2) address the dissemination of inaccurate information that triggers bank runs.

In light of these recommendations, New York banks should expect to see changes to the NYDFS supervisory framework and process in the coming months and years.

Proposed Guidance on Assessment of the Character and Fitness of Directors, Senior Officers and Managers

Also following the March failure of Signature Bank, the NYDFS issued proposed guidance in May to all New York state-regulated banking organizations and nondepository financial institutions licensed or chartered under the New York Banking Law on new expectations regarding the vetting of the character and fitness of directors and senior officers.[3]

In the accompanying press release, Superintendent Adrienne A. Harris stated, "In light of recent events, this updated guidance takes on even greater relevance, as we work to ensure New Yorkers can have confidence in the management of our state's financial institutions".[4]

The proposed guidance would cover vetting of each member of a covered institution's board of directors, board of trustees and/or board of managers, as applicable, and each senior officer, i.e. designated person.

Similar to federal banking regulations, the term "senior officer" is interpreted to include any officer with the authority to participate in major policymaking functions, without regard to official title or the individual's compensation.[5]

In addition, any chief executive officer, chief financial officer, chief operations officer, chief compliance officer, chief legal officer, chief risk officer, president, senior executive vice president, executive vice president, secretary of the board of directors, or treasurer is presumed to be a senior officer, unless they are excluded from participation in major policymaking by resolution of the board of directors or in the bylaws.

Covered institutions would be required to have policies and procedures requiring vetting of designated persons' character and fitness both at onboarding and on a regular ongoing basis. An onboarding review also would be expected to be conducted upon consummation of

various corporate or organizational transactions — including reorganizations or restructurings — such as a merger or acquisition, a change of control, or a purchase and assumption agreement.

In addition, covered institutions would be expected to require that designated persons make updates on an ongoing basis in response to intervening circumstances or if they determine that previously submitted information was materially incorrect or has materially changed.

A covered institution's framework for assessing a designated person's character and fitness would be expected to include sensitive issues, warning signs and other indicators that, if identified, warrant additional scrutiny before the individual is onboarded, permitted to commence services or permitted to remain in their position.

The proposed guidance includes a list of suggested questions that a covered institution may adopt for use in the assessment process. Covered institutions would be permitted to tailor these suggested questions to their specific business needs, operations and risks.

Findings from the character and fitness assessments would be required to be reported to the covered institutions' board of directors and chief compliance officer, or equivalent. Covered institutions would be required to promptly notify the NYDFS if a designated person is removed, transferred or has their functions modified as the result of a materially adverse finding during an ongoing character and fitness assessment.

Comments on the proposed guidance were due June 30.

Crypto Regulation, Protection, Transparency and Oversight Act

On May 5, New York Attorney General Letitia James released a proposed bill that would establish a comprehensive framework for the regulation of digital asset activities in the state of New York.[6] The Crypto Regulation, Protection, Transparency and Oversight, or CRPTO, Act would apply to persons engaged in activities of a digital asset issuer, marketplace, broker, investment adviser or influencer, each as defined in the act, from or within New York.

Broadly speaking, the law would extend much of the existing regulatory structure for securities and commodities to digital assets, including limitations and rules designed to eliminate conflicts of interest, require public reporting of financial statements, increase transparency, and protect customers and investors from fraudulent practices.

The CRPTO Act touches on many concerns that have been raised by lawmakers and regulators about the practices of digital asset platforms, including the issue of digital asset intermediaries playing multiple crucial roles in the industry without appropriate ring-fencing or risk management.

Among other things, the act would limit the ability of certain intermediaries to act in more than one capacity, trade for their own accounts, provide referrals for compensation, borrow or lend customer assets, and issue debt or accept demand deposits. The act would require digital asset intermediaries to comply with many rules applicable to traditional assets, including "know-your-customer" and anti-money laundering rules.

The act also includes provisions requiring certain intermediaries to maintain possession or control of custodied assets, disclose fees and commissions, and have in place effective cybersecurity programs.

Under the proposed bill, digital asset issuers would be required to publish and distribute prospectuses and make public disclosures meeting certain minimum standards. Stablecoin issuers also would be required to maintain a ratio of U.S. currency and high-quality liquid assets of at least 1.0 at all times.

The bill includes requirements for digital asset marketplaces to adopt and publish listing standards and make public certain data, including prices and volume of transactions.

Digital asset promoters would be required to register and disclose their ownership interests and compensation. The bill also includes anti-fraud and manipulation provisions and protections for customers of unauthorized digital asset transfers similar to those provided under the federal Electronic Fund Transfer Act.

The CRPTO Act would grant the attorney general jurisdiction to enforce any violation of the law and codify the NYDFS' authority to supervise and examine digital asset brokers, digital asset marketplaces, digital asset investment advisers and digital asset issuers. The bill is expected to be considered during the 2023 legislative session by the state Senate and Assembly.

Other Notable Developments

In April, the DFS adopted a regulation — Title 23 of the New York Codes, Rules and Regulations, Part 102[7] — providing the basis for how so-called BitLicensees will be assessed for the costs of supervision and examination by the DFS.

BitLicensees that also hold a money transmitter, limited purpose trust company or banking license will be billed separately for each license. The total annual assessment for BitLicensees will include a supervisory component and a regulatory component.

The supervisory component will be based on the categorization of the licensee as small, medium or large, as determined under the calculation described in the rules. Licensees will be billed five times in a fiscal year, including quarterly estimated assessments and a final true-up assessment. Special assessments are permitted under the rules.

In May, the New York state Legislature passed legislation — S.B. S5972 and companion A.B. A5519[8] — that, if signed by the governor, would empower the NYDFS to regulate fees related to consumer bank accounts. More specifically, the legislation would allow the NYDFS to promulgate regulations under the Banking Law for consumer accounts related to:

- The manner in which banking organizations process debit and credit transactions;
- The charges that may be imposed in relation to checks or electronic transfers drawn on a consumer's account that has insufficient funds;
- The charges that may be imposed in relation to deposited checks or written orders that are dishonored and returned by the drawee;

- Disclosures to consumers related to processing of transactions and associated fees; and
- Alerts, notices and other disclosures relating to the imposition of the fees and charges described above.

Finally, in June, the New York state Legislature passed an amendment to the New York cannabis law that would permit the Office of Cannabis Management to share applicant and licensee information with requesting financial institutions.[9]

If signed into law, the amendment would allow financial institutions to access information about prospective cannabis clients with their consent. Such access would assist the financial institution with its verification of the clients' personal and financial data and compliance with know-your-customer and federal reporting requirements.

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[1] https://www.dfs.ny.gov/system/files/documents/2023/04/nydfs_internal_review_rpt_signature_bank_20230428.pdf.

[2] The FDIC also issued a report regarding Signature Bank in April. FDIC's Supervision of Signature Bank (April 28, 2023), available at <https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf>. The FDIC's report similarly found that the "root cause" of the bank's failure was "poor management," including growth that outpaced controls, failing to prioritize good corporate governance and failing to implement fundamental liquidity risk management. *Id.* at 2.

[3] https://www.dfs.ny.gov/industry_guidance/industry_letters/il20230509_guidance_assessment_fitness.

[4] https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202305091.

[5] See, e.g., 12 CFR 215.2(e)(1), 225.71(c).

[6] <https://ag.ny.gov/sites/default/files/2023-05/Crypto%20Bill%2010985-06-3.PDF>.

[7] https://www.dfs.ny.gov/system/files/documents/2023/04/rf_finservices_23nycrr102_text.pdf.

[8] <https://www.nysenate.gov/legislation/bills/2023/s5972>; <https://www.nysenate.gov/legi>

slation/bills/2023/a5519.

[9] <https://www.nysenate.gov/legislation/bills/2023/s1047/amendment/a>; <https://www.nysenate.gov/legislation/bills/2023/a7388>.