INSTITUTE *of* INTERNATIONAL FINANCE

IIF U.S. Regulatory Update

February 19, 2021

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U.S. POLITICAL UPDATE

President Biden's financial agenda

President Joe Biden has identified the following economic and financial policies for his administration: COVID-19 recovery (both from a health and economic perspective), tackling climate change, and addressing racial inequality.

While Democrats have control of both the Senate and House of Representatives, their majorities are razor thin. Such a margin makes it unlikely for the Democrats to be able to push financial reform through legislation. It is also unlikely that the administration or Congress will make significant financial reform an early focus given the desire to prioritize COVID-19 and other more pressing issues.

Therefore, financial regulatory reform is likely to be driven by the regulatory agencies, where key personnel are currently being appointed by President Biden, or in some cases, when urgent, via Executive Order by the President himself.

Climate risk: Addressing climate change is expected to be a considerable focus of the Biden administration's financial agenda and will also inform agency work plans. U.S. financial regulators will likely engage internationally on climate risk and sustainability standards and will work closely on a bilateral and multilateral basis with regulators in other countries.

Prudential regulation: President Biden's appointed regulators are expected to call for stricter capital and liquidity requirements, especially for large banks, and to evaluate and consider changes to some rules such as those concerning stress testing, leverage requirements, living wills, and dividend/stock buyback restrictions. Additionally, Basel III implementation plans will likely be announced this year. A new priority area for the Fed and other regulators will be fighting racial inequality and reaching underserved communities.

Non-financial risk: The Treasury Department, led by Janet Yellen, will be responsible for implementing elements of the Anti-Money Laundering Act of 2020 which includes requiring disclosure of beneficial ownership information to Treasury's Financial Crimes Enforcement Network (FinCEN), which will prevent the formation of anonymously held shell companies. Cyber risk and operational resilience are additional areas where work is expected to continue given the recent SolarWinds hack and other experiences during recent months.

Non-bank financial intermediation: We expect the incoming administration to focus on non-bank financial intermediation (NBFI). Given recent market volatility in March 2020, interest in greater regulation of NBFI has grown internationally at the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO).

Insurance: Under the Biden administration, insurers can generally expect higher levels of prudential supervision, as well as a focus on market conduct issues such as sales practices and risk-based pricing. ESG goals will likely take an important role in supervision as sustainability and equality are emphasized by the administration.

Overall Biden Financial Agenda: On January 15, the IIF issued a paper – Expectations for Biden's Approach to Financial Regulatory Policy – providing further information on the topics outlined above.

SENIOR REGULATORY ANNOUNCEMENTS

Department of the Treasury

Janet Yellen was sworn in as Secretary of the Treasury on January 26. Secretary Yellen formerly served as Chair of the Federal Reserve and Chair of the Council of Economic Advisors. Her early focus so far has been on passing economic recovery legislation. Secretary Yellen will lead regulatory interagency coordination as Chair of the Financial Stability Oversight Council (FSOC).

Adewale ("Wally") Adeyemo, who served as G20 Sherpa and Deputy National Security Advisor under President Barack Obama, was nominated to serve as Deputy Treasury Secretary.

Federal Reserve Board of Governors

Christopher Waller joined the Federal Reserve Board on December 18, 2020 after being nominated by President Trump. He previously served as research director for the Federal Reserve Bank of St. Louis and has a background in macroeconomics and academia. There is now one empty seat on the Federal Reserve Board which President Biden will fill. Economist Lisa Cook of Michigan State University has been mentioned as a potential nominee.

Federal Deposit Insurance Corporation (FDIC)

Trump appointee Jelena McWilliam's term lasts until 2023 and she has stated she plans to remain in her position until then.

Office of the Comptroller of the Currency (OCC)

Blake Paulson currently serves as Acting Comptroller of the Currency after Brian Brooks resigned at the end of President Trump's term. President Biden has not yet announced his nominee to lead the agency.

Consumer Financial Protection Bureau (CFPB)

Rohit Chopra has been nominated by President Biden to lead the CFPB. A former assistant director of the bureau, he is likely to take an aggressive approach to consumer protection.

Commodity Futures Trading Commission (CFTC)

Trump appointee Heath Tarbert stepped down as chair but will remain a commissioner. Rostin Behnam is serving as acting chair. President Biden has not yet named his nominee for chair.

Securities and Exchange Commission (SEC)

Gary Gensler was nominated by President Biden to serve as Chair of the SEC. He is a former Chair of the Commodity Futures Trading Commission and served as an Under Secretary at the Department of the Treasury.

FEDERAL AGENCIES

Fed releases 2021 stress test scenarios

The Federal Reserve on February 12 released the hypothetical scenarios for its 2021 stress tests. The "severely adverse" hypothetical includes a recession in which unemployment rises by 4% to 10.75% in Q3 2022 and GDP falls by 4% by Q3 2022. Asset prices also experience a sharp decline in the scenario. Banks with large trading operations will also need to incorporate a market shock and/or the default of their largest counterparty. 19 large banks will participate in the test (with smaller banks given the option to opt-in). Last year's stress tests found that banks were well-capitalized, but the Fed enforced capital distribution restrictions given continuing economic uncertainty.

Fair access rule publication paused

The OCC paused the publication of the fair access rule in the Federal Register so that the next Senate-confirmed comptroller can review it before it goes into effect. The rule would prohibit large banks from refusing to do business with certain companies if they meet certain impartial standards. Former Acting Comptroller of the Currency Brian Brooks finalized the rule in his last days in office and it was predicted that the Biden administration would seek to review it.

Fed still to decide on Q2 dividends

Federal Reserve Chair Jerome Powell said at the January 27 Federal Open Market Committee meeting that the Fed has not yet determined its approach to share buybacks and dividends for the second quarter of this year. Restrictions were placed on capital distributions last year in response to the economic fallout from COVID-19. Those restrictions were then relaxed for Q1 2021 because banks have weathered the crisis well and performed well on stress tests. Further economic data and vaccine rollout information will be needed for the Fed to decide for Q2.

Fed joins NGFS

The Federal Reserve announced on December 15, 2020 that it had joined the Network for Greening the Financial System (NGFS). The announcement comes after more than a year of discussions between the central bank and the NGFS. All five members of the Fed board voted to join. The U.S. has been criticized for falling behind other countries in its policy towards climate change and sustainable finance; this announcement, along with President Biden's broader climate risk agenda, signals growing concern and intent to engage internationally on climate risk issues. Lael Brainard, a member of the Fed Board of Governors, spoke at a virtual IIF event on February 18, describing how important it is for financial institutions to be resilient to climate risks. She said the Fed is involved with NGFS work on microprudential and macrofinancial impacts of climate change, green finance, data gaps, and research.

Regulators issue new cyber rule

The Federal Reserve, OCC, and FDIC on December 18, 2020 issued a proposed rule that would require banks to notify their regulator of a "computer security incident" within 36 hours of the event but preferably as soon as possible. The rule intends to enforce immediate communication between regulators and their supervised institutions in case the latter experiences a cyber incident that could prevent them from working with their customers or even potentially destabilize the financial system. The proposed rule would also require service providers to notify banks they work with if they experience a cyber security breach.

SEC consults on Money Market Funds

In December 2020, the SEC released a report focusing on analyzing the interconnections among the various U.S. credit markets and whether these interconnections have contributed to or mitigated risks during the March 2020 market turmoil. The President's Working Group on Financial Markets (PWG) also released a report in December which focuses on analyzing the market turmoil and potential policy recommendations particularly for money market funds (MMFs).

On February 4, the SEC requested comments on potential reform measures to improve the resilience of MMFs. The consultation is based on the PWG's report and comments are requested on the effectiveness of previously enacted MMF reforms and potential policy measures, including measures touched upon in the report. The deadline for the response is April 12 and the IIF is considering responding to through the new IIF Non-bank Financial Intermediation (NBFI) Working Group.

NAIC announces 2021 priorities

The National Association of Insurance Commissioners (NAIC) announced its 2021 regulatory priorities on February 9. The priorities include supporting their members as they respond to COVID-19, ensuring that minority groups have access to insurance, addressing climate risk, and examining the use of artificial intelligence in the industry.

Additional regulatory announcements

The IIF is maintaining a tracker of prudential regulatory actions taken in response to COVID-19 by the U.S., other G20 countries and other leading jurisdictions and organzations. The tracker, which is updated weekly and can be found on the IIF website here by downloading the "COVID-19 Regulatory Measures" document, will provide the most up-to-date overview of U.S. regulatory responses.

CAPITOL HILL UPDATES

Senator Brown becomes Chair of Senate Banking

Given the Senate's Democratic flip in January after two victories in Georgia, Senator Sherrod Brown of Ohio is the new chair of the Senate Banking Committee. Senator Pat Toomey (R-PA) will serve as ranking member of the committee. Senator Brown, a progressive member of the party, said he will focus on serving workers over Wall Street. A Democrat-led Senate Banking Committee can be expected to demand tougher bank regulation and to work for the incorporation of sustainability, racial equality, and greater consumer protection in financial regulators' agendas. The committee can also be expected to approve President Biden's nominees.

AML Act of 2020 passed as part of NDAA

Key anti-money laundering (AML) legislation (the AML Act of 2020) was included in the FY2021 National Defense Authorization Act (NDAA). The act substantially modernizes elements of the U.S. AML regime, the Bank Secrecy Act (BSA), and effectively outlaws anonymous shell companies. The act will require companies to reveal their beneficial ownership information to FinCEN when they are found to crack down on shell companies and aid the fight of financial crime. Industry has supported this change as it moves the burden of customer verification from financial institutions to the customers themselves who must disclose their identities to FinCEN. The act also requires Treasury to release national AML priorities, seeks to improve public-private sector collaboration, expands cryptocurrency regulation, and more.

Yellen testifies before Senate Finance Committee

Janet Yellen's confirmation hearing to serve as Secretary of the Treasury was held by the Senate Finance Committee on January 19. Her experience was praised by senators from both parties, and she was confirmed swiftly. Questioning mainly revolved around taxes and COVID-19 recovery.

Some Republicans expressed concern about the impact that President Biden's proposed $1.9 trillion recovery plan will have on the growing national debt. Secretary Yellen, however, while mindful of the country's growing debt burden, explained this is a time for significant fiscal spending to address the COVID-19 health and economic emergency. She is concerned that if the government does not respond aggressively, the U.S. will face long-run growth and employment problems. Secretary Yellen also plans to make climate risk a top priority of the Treasury Department and will also oversee the swift implementation of the AML Act of 2020.

Cecilia Rouse testifies before the Senate

The Senate Banking Committee on January 28 held a confirmation hearing for Cecilia Rouse, a Princeton economist who has been nominated by President Biden to serve as chair of the Council of Economic Advisors (CEA). Her research has been centered on the labor market and inequality which closely align with the Biden administration's current focuses. Dr. Rouse previously served on the CEA during the Obama administration and on the National Economic Council during the Clinton administration and is currently dean of the Princeton School of Public and International Affairs. It is likely Dr. Rouse will gain bipartisan support on the Senate Banking Committee.