CADWALADER

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In This Issue ...

Welcome to this week's edition of *Cabinet News and Views* covering the latest speeches and publications by U.S., UK and Asia government agencies and their leaders on recent developments in the banking industry.

My colleague, Mercedes Kelley Tunstall, provides two updates on the Consumer Financial Protection Bureau. She reports on a recent speech by CFPB Director Rohit Chopra addressing concerns regarding technology companies and other nonbanks getting involved in the creation and issuance of stablecoins; and reviews the publication of a CFPB Advisory Opinion regarding “Consumer Information Requests to Large Banks and Credit Unions.”

FRB Governor Bowman has been fairly prolific in speaking recently, with a speech on Responsible Innovation in Money and Payments on Tuesday, that I would commend to anyone interested in the CBDC discussion, but I take a look at Governor Bowman’s remarks she made in Morocco last week on the financial stability risks and vulnerabilities she is most focused on and her views on the overall resilience of the U.S. banking system.

My colleague Alix Prentice examines a speech by Sam Woods, the Deputy Governor for Prudential Regulation and CEO of the Prudential Regulation Authority, on this year’s banking failures, the lessons learned and priorities going forward for the Authority.

My colleagues Jason Halper and Sara Bussiere discuss a recent directive issued by The Hong Kong Monetary Authority, Hong Kong’s de facto central banking institution, for banks setting out high-level principles on planning for a transition to a net-zero economy.

Finally, by way of preview, both the FRB and FDIC have given Sunshine Act notices for open meetings next week. The FRB will have an open meeting on October 25 proposing revisions to Reg. II on debit interchange. The FDIC’s October 24 open meeting will consider a final rule on the Community Reinvestment Act and an Interagency Policy Statement on climate-related financial risk management. We will plan to cover those important topics next week.

As always, we welcome your thoughts. Just drop me a note here.

Daniel Meade
Partner and Editor, *Cabinet News and Views*

CFPB Warns of Dangers Related to Nonbanks Managing Payments and Issuing Stablecoins Outside of the Banking System

By **Mercedes Kelley Tunstall**
Partner | Financial Regulation

On October 6, 2023, Rohit Chopra, the Director of the Consumer Financial Protection Bureau ("CFPB"), gave a speech at the Brookings Institute's "Payments in a Digital Century" event. In his prepared remarks, Chopra frankly addressed concerns regarding technology companies and other nonbanks getting involved in the creation and issuance of stablecoins and blurring "the lines between payments and commerce [in such a way that it] creates the incentives for excessive surveillance [of consumers and their spending habits] and even financial censorship." He ended his speech by announcing that the CFPB will issue a proposed rule later this October regarding personal financial data rights.

As he addressed concerns regarding the participation by nonbanks in the payments sector, Chopra explained that today "we give banks special legal treatment to issue deposits and influence the supply of money in the economy. We afford them access to the public safety net to ensure this money is safe and reliable. In return, banks are subject to regulation and supervision and are supposed to meet the needs of the community. To prevent conflicts of interest, anticompetitive behavior, and undue risk-taking, banks are also limited to certain financial activities, rather than allowing them to engage in commercial enterprise or be merely an arm of a larger conglomerate."

With the development of person-to-person payment networks, digital currencies and digital wallets, Chopra expressed concern that some of these payments activities are managed by very large and diversified technology companies that do not have to play by the same restrictive rules that banks play by. In particular, he describes three "clear takeaways" identified by the CFPB while they examined these nonbank companies:

1. These companies collect "a significant amount of data about the consumers using their payment products" and use the data to support the development of new products and services;
2. These companies retain the data for extended period of time after requiring that consumers agree to share their data or else they cannot use the payment technology; and
3. These companies tend to shift how they say they will use this data because "their regulations do not appear to commit to meaningful limitations on future efforts to monetize the data."

Chopra also discussed the creation of so-called "private money" (aka stablecoins) by nonbanks and the risks posed by the introduction of stablecoins for consumer transactions. He referenced the Department of the Treasury's report on stablecoins from 2021, describing it as "interesting" and prescribing five steps the CFPB will take to "ensure that private digital dollars and payments systems in the household and retail context do not harm consumers":

1. In an effort to better understand the data collected by the big technology companies, the CFPB will issue orders so that the CFPB can acquire and examine that data;
2. The CFPB will explore providing guidance regarding the applicability of the Electronic Funds Transfer Act and Regulation E to stablecoins and virtual currency transactions;
3. The CFPB will expand its supervisory scope to examine large nonbank payment platforms;
4. The CFPB encourages the Financial Stability and Oversight Council (FSOC) to designate stablecoins and virtual currency as systemically important payment activity; and
5. The CFPB will issue a proposed rule later this month regarding “personal data financial rights.”

FRB Governor Bowman Speaks on Financial Stability

By **Daniel Meade**
Partner | Financial Regulation

Last week, Federal Reserve Board ("FRB") Governor Michelle Bowman gave a speech entitled Financial Stability in Uncertain Times, focusing on the "financial stability risks and vulnerabilities" she is most focused on.

Gov. Bowman started her remarks on risk with the banking sector and that while the banking sector experienced stress this spring "the events of earlier this year have underscored the strength and resilience of the overall U.S. banking system." Gov. Bowman noted that the interest rate environment does create some stresses, but noted that all banks subject to this year's stress tests passed. Gov. Bowman also noted that commercial real estate values following the COVID-19 pandemic is a risk the regulators are watching closely. She also noted that she is "also closely watching other financial stability vulnerabilities posed by large nonbank financial institutions" and risks to the smooth functioning of the U.S. Treasury markets.

Gov. Bowman went on to note that "not all of the financial stability risks and vulnerabilities that I have highlighted require policy changes. In fact, it is possible that an overreaction in adjusting policies in light of recent stresses could worsen conditions rather than ameliorate them." She went on to note that there's a proper balance between supervision of individual institutions and regulation of the entire banking section and that "bank supervision cannot simply rely on pinpointing compliance issues, failed processes, or rule violations. It must go further to examine a bank's risk exposures while prioritizing core safety and soundness issues in the context of the bank's financial condition." In terms of that balance, Gov. Bowman said "[t]he vast majority of improvements to supervisory functions could be accomplished without broad changes to the regulatory framework."

Gov. Bowman cautioned policymakers to "carefully consider whether the contemplated significant increases in capital requirements in the United States related to the finalization of Basel III capital standards meet [the] standard for being efficient and appropriately targeted."

These comments from Gov. Bowman seem to suggest she continues to be skeptical of the Basel III Endgame proposal in which she dissented, and suggests a strong preference for tailored supervision rather than a wholesale regulatory approach to promote financial stability.

CFPB Announces Large Banks and Credit Unions May Not Charge for Account Information

By **Mercedes Kelley Tunstall**
Partner | Financial Regulation

The Consumer Financial Protection Bureau ("CFPB") announced last week the publication of an Advisory Opinion regarding "Consumer Information Requests to Large Banks and Credit Unions." The Advisory Opinion applies to "large banks and credit unions", which means those with $10 Billion or more in assets, and will begin to be enforced against these institutions starting February 1, 2024.

The Advisory Opinion interprets a provision of the Consumer Financial Protection Act (CFPA), 12 U.S.C. 5534(c) (also known as Section 1034(c) of the CFPA), that has not previously been addressed or enforced by the CFPB. The basis for many of the CFPB's statements in the Advisory Opinion appears to be driven by their review of comments responding to a Request for Information (RFI) the CFPB issued to consumers in June of 2022, asking consumers for their input on customer service at large banks and credit unions. The CFPB received 1305 comments responding to the RFI, 382 of which the CFPB has posted for perusal at regulations.gov.

Section 1034(c) states that large banks and credit unions "shall, in a timely manner, comply with a consumer request for information in the control or possession of [a large bank or credit union] concerning the consumer financial product or service that the consumer obtained from [the large bank or credit union], including supporting written documentation, concerning the account of the consumer."

The CFPB's Advisory Opinion expounds in-depth, to the tune of 17 pages, upon this provision of the CFPA, turning three times to standard dictionaries (including the Oxford English Dictionary, Merriam-Webster and Black's Law Dictionary) for definitions of terms such as "supporting", "concerning" and "shall."

In sum, the CFPB has concluded that large banks and credit unions "frequently rely on highly standardized processes rather than high-quality human interactions or digital channels that actually facilitate self-help" and therefore consumers often must "navigate a phone tree in the hope of speaking to the right person in a call center, [search] through largely irrelevant material on a web site to try to find the information they need, or [attempt] to get a clear answer from a chatbot." As a result, the CFPB intends to address this situation by requiring that affected financial institutions allow consumers to request information regarding their accounts without fees, in a timely manner and without requiring unreasonably difficult methods for submitting such requests.

The information that affected financial institutions should be prepared to provide to consumers without fees, and upon request, includes at least all of the below:

- Information that appears on periodic statements and online account portals;
- Bill payments and recurring transactions that affect the account;

- Terms and conditions of the account;
- Copies of the original, signed agreement between the institution and the consumer; and
- Status of a previously requested lien release.

In reaching the conclusion that affected institutions may not charge fees for this kind of information, the Advisory Opinion first states that Section 1034(c) does not "contain any language stating or suggesting that a large bank or credit union may impose conditions that unreasonably impede consumers' information requests" and then concludes that fees would be an unreasonable impediment because, "[s]ome consumers cannot afford to pay even a small fee to obtain information about their accounts."

While the CFPB does acknowledge that repeated requests for the same information from a consumer could probably justify a fee being charged, the Advisory Opinion clearly states that charging a fee in any of the following circumstances would be in violation of Section 1034(c), many of which presently do incur a fee at financial institutions:

1. Responding to consumer inquiries regarding their deposit account balances;
2. Responding to consumer inquiries seeking the amount necessary to pay a loan balance (*i.e.*, to receive a pay-off quote);
3. Responding to a request for a specific type of supporting document, such as a check image or an original account agreement; and
4. Spending time on consumer inquiries seeking information and supporting documents regarding an account.

The CFPB addresses other aspects of providing responses to consumer requests in the Advisory Opinion that could lead to enforcement actions under Section 1034(c) including the timeliness of responding to various requests and other impediments that may be considered unreasonable, such as very long wait times on customer service lines and only recent account information being made available, even though the financial institution "retains" account information for several years. Finally, the CFPB takes aim at the use of "chatbots" by large financial institutions, concluding that such use "may violate section 1034(c) if they employ technologies that do not properly recognize consumer information requests or that provide inaccurate or incomplete information in response to those requests."

The UK’s Chief Banking Regulator Talks About Lessons Learnt About Managing Bank Failures

By **Alix Prentice**
Partner | Financial Regulation

In a speech published on 16 October, Sam Woods the Deputy Governor for Prudential Regulation and CEO of the Prudential Regulation Authority (“PRA”) discussed this year’s banking failures, the lessons learnt and priorities going forward in the work that needs to be done to "*improve and refine the regulatory regime for banks*". While dismissing the idea of a zero-failure regime, the speech does examine the efficacy of tools to accommodate the PRA’s "*zero appetite for systemic financial crises*":

- **Measuring risk correctly**: Woods points to variability of risk-weights across firms and jurisdictions as being a drain on confidence in the banking system that upcoming Basel 3.1 refinements are intended to address. Interestingly, Woods does not believe that there will be a meaningful increase in aggregate capital levels for UK banks as a result of Basel 3.1 roll-out;

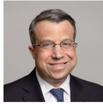
- **Liquidity requirements**: The speech points out that the current framework for liquidity regulation is focused on wholesale funding volatility but that recent events have shown that there is a need also to look at depositor sentiment and access to central bank liquidity;

- **The importance of credibility and profitability to depositor and investor sentiment**: Again in light of recent events, the importance of non-financial regulation and supervision of issues that can impact credibility and profitability like risk culture and governance needs to be reasserted, and supervisors should be asking whether business models are viable and sustainable;

- **Depositor continuity**: The PRA and the UK’s Treasury are exploring options to ensure continuity of access to deposits for smaller banks in resolution which do not have the option of bailing in long-term debt;

- **Branches**: The PRA is going to be thinking about their approach to branching (as opposed to subsidiarisation) with a view to targeted improvements rather than fundamental reforms in order to achieve greater degrees of assurance over resolution arrangements.

Hong Kong's Central Banking Institution Directs Banks to Ramp Up Net Zero Transition Planning


By **Jason M. Halper**
Partner | Global Litigation

By **Sara Bussiere**
Special Counsel | Global Litigation

The Hong Kong Monetary Authority ("HKMA"), Hong Kong's de facto central banking institution, issued a directive for banks setting out high-level principles on planning for a transition to a net-zero economy. In a "Dear CEO" letter dated August 29, 2023, to all authorized institutions, Daryl Ho, Executive Director of the Banking Policy Division, directed banks to integrate net zero transition into their planning activities by (i) aligning their objectives with net zero, and (ii) incorporating net zero into their internal processes. The HKMA stated that the new principles are geared towards helping banks maintain "safety and soundness in the transition."

The high-level principles set out in the letter are:

- **Setting clear objectives and targets:** These objections and targets can vary from institution to institution. For some, objectives might include development of a transition strategy, whereas others might focus on a risk management process. Targets need to be aligned with the 2015 Paris Agreement.

- **Establishing a robust governance framework and embedding transition considerations into internal processes:** This framework should go beyond basic corporate governance; while board and executive oversight are key, net-zero transition planning should factor into relevant strategies, business models, and the bank's products and services.

- **Operationalizing these objectives through appropriate initiatives and actions:** This principle is more relevant for institutions that have objectives that include a transition strategy, rather than simply transition risk management. When possible, banks should seek to establish quantifiable milestones.

- **Proactively engaging with clients:** Banks should actively support their clients in a net-zero transition, including by collecting relevant information on risks and opportunities across disparate sectors.

- **Undergoing reviews and making updates to transition plans accordingly:** Reviews should be frequent so that updates can be made to transition strategies in a timely manner.

- **Maintaining transparency:** Whenever possible, banks should seek to increase the transparency of their transition planning processes.

These high-level principles apply to all authorized institutions in Hong Kong, including those that are local subsidiaries or branches of foreign banks. HKMA noted that, while net-zero transition planning is generally conducted by the bank's head office, it is incumbent upon all foreign banks, including local branches, to take net-zero transition planning into account with respect to their activities in Hong Kong.

Three-Phased Approach and Guiding Documents

HKMA relied on several guiding documents and policies in its development of these high-level principles. This effort is part of HKMA's three-phased approach. Phase I featured the development of a common assessment framework. Phase II focused on supervisory requirements, and initial thoughts on the approach to addressing climate-related and broader sustainability issues. HKMA is now in Phase III, in which the HKMA is assessing banks' progress in satisfying supervisory requirements.

With the ongoing implementation of Phase III raising the bar on green and sustainable banking, HKMA has also reviewed the findings and recommendations of several international bodies in the formation of its net-zero transition high-level principles, including the Network of Central Banks and Supervisors for Greening the Financial System (NGFS)'s "Stocktake on Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities" (May 2023), the Glasgow Financial Alliance for Net Zero (GFANZ)'s "Financial Institution Net-zero Transition Plans: Fundamentals, Recommendations, and Guidance" (November 2022) and the Task Force on Climate-related Financial Disclosures' "Guidance on Metrics, Targets and Transition Plans" (October 2021).

Final Thoughts

As we have discussed at length, including recently here and here, financial regulators are increasingly focused on climate risk management, which has been a key HKMA supervisory focus since 2019. While it may seem that establishing high-level principles on the net-zero transition for HKMA's authorized institutions should have little downside, some commenters have observed that international standards are still in flux. The recent release of HKMA's principles typifies the issue in sustainable banking and the net-zero transition more broadly: stakeholders (and industry) seek clarity, and divergent standards pose challenges for institutions regulated in multiple jurisdictions. HKMA acknowledges that future updates might come from several sources, including The Basel Committee on Banking Supervision, which is the primary global standard setter for the prudential regulation of banks and whose guidance we have previously discussed. It is also likely that continued dialogue within the industry will prompt updates to HKMA's own guiding principles. Ultimately, HKMA's announcement is a continuation of the trend of frequent jurisdiction-specific updates to net-zero transition planning.

(This article originally appeared in Cadwalader Climate, a twice-weekly newsletter on the ESG market.)