Our Take

PwC’s Financial Services Update

Change remains a constant in FS risk & regulation.

5.21.21 Topics: Climate * OCC * CBDCs * SEC * On our radar

1. President Biden signs Executive Order on Climate-Related Financial Risk

Yesterday, President Biden signed an Executive Order (EO) calling for a wide range of actions to combat risks to the economy and financial system stemming from climate change. Specifically, the EO directs the National Climate Advisor and the Director of the National Economic Council to develop a government-wide climate-related financial risk strategy within 120 days. It also encourages Treasury Secretary Janet Yellen to use her role as head of the Financial Stability Oversight Council (FSOC) to lead the financial regulators to assess climate-related financial risk to the US financial system. As part of this effort, the EO suggests that the FSOC member agencies issue a report within 180 days outlining actions they are taking to reduce climate-related risks to financial stability, including efforts to enhance disclosures and changes to their supervisory activities. It also requests that the report include recommendations for processes to identify climate-related risks to financial stability.

The EO also directs the Labor Secretary to suspend, revise, or rescind last year’s rule that requires retirement account managers to select investments based solely upon “pecuniary factors” - i.e., factors that have a material impact on risk or returns of an investment rather than environmental, social, and governance (ESG) factors. Retirement plan managers currently have until April 30, 2022 to demonstrate compliance. It also directs the Federal Insurance Office to assess climate-related issues or gaps in the supervision and regulation of insurers.

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Four months in, the Biden Administration is keeping up a steady pace of action to combat climate change. This latest EO comes as no surprise given the Administration’s commitment to combat climate-related risk through economic as well as environmental policy. It also makes clear that the Administration intends to practice what it preaches by pressing the federal agencies to review and reduce their own climate risk exposure. While Secretary Yellen has already indicated that she would seek to coordinate climate policy through the FSOC, the recommendation and outline of areas to consider provides authority and a clearer direction for doing so. Although the EO does not explicitly require the FSOC agencies to publish a report, we expect them to do so. The 180-day timeframe will serve as a key window to watch the agencies continue to make progress on their climate objectives. Based on the agencies’ public communications to date, we could expect to see discussion of areas such as enhanced disclosures, the regulators’ approach to supervising climate risk management, and the possibility of climate stress testing.

The DOL’s ESG investing rule was met with strong opposition from Congressional Democrats, sustainable investment groups, and the asset management industry. Given its incongruence with the Administration’s stated policy goal of advancing climate-friendly investment, it is just a matter of time - and administrative law - for the rule to be reversed. The DOL has already announced that it would not enforce the rule, but asset managers should still make sure that they are meeting their fiduciary obligations and have the necessary data to back up any ESG-related claims.
2. Acting Comptroller Hsu on the Hill

On Wednesday, OCC Acting Comptroller Michael Hsu testified before the House Financial Services Committee in his first appearance since assuming the role last Monday. His remarks included the following topics:

- **Community Reinvestment Act (CRA).** Hsu noted that he requested a review of the CRA reform rule finalized in May 2020. Among other reforms, the rule clarified activities that count toward CRA obligations, updated assessment area criteria to take into consideration the rise of digital banking, and sets forth a metrics-based evaluation framework (see our First Take on the rule). In his testimony, Hsu indicated that he supports strengthening the CRA by considering the impact of the pandemic on minorities, rural communities and vulnerable groups as well as taking into account feedback from public comments and lessons learned from the rule’s partial implementation. He also indicated a preference for a single joint rule with the Fed and FDIC. One day before his testimony, the OCC released a statement that it is reviewing the CRA reform rule and halting the implementation of most of its provisions.

- **Innovation, fintech and cryptocurrency.** Stating that innovation such as fintech, machine learning and distributed ledger technology “cannot be stopped,” Hsu explained that his goal will be to encourage responsible innovation as part of an overarching strategy developed in conjunction with other regulators. As part of that, he announced that the federal bank regulators have discussed putting together an “interagency policy sprint team” on crypto. He noted that he has asked staff to review the OCC’s interpretive letter positioning that chartered institutions may provide cryptocurrency custody services, citing concerns that it was issued without coordinating with all stakeholders and not as part of a broader strategy. He also provided his view on the OCC’s pursuit of offering special purpose charters to fintechs, noting that he shares concerns that refusing to charter fintechs will push them out of the reach of regulators. However, he also will look to holding any chartered fintechs to high consumer protection and fair lending standards while coordinating closely with the Fed and FDIC.

- **Climate change.** Climate change was highlighted by Hsu as one of his key priorities, and he said that he has asked OCC staff to develop options for taking concrete actions, including potentially evaluating bank practices related to climate risk identification, measurement and risk management. In what became a theme throughout his remarks, he noted that he intends to collaborate closely with other regulators and market participants in developing climate change policy. To that end, Hsu also said he is exploring joining the Network for Greening the Financial System (NGFS), an organization of central banks and supervisors focused on the role of mitigating climate change via the financial system. The Fed joined the NGFS in December of last year, but the OCC and FDIC have not yet joined.

- **Risk management.** Hsu warned that “the banking system, especially large banks, is at risk of becoming complacent” and highlighted the Archegos incident as an example of the importance of sound risk management. He described the risks outlined in the OCC’s Semiannual Risk Perspective, which was released ahead of the hearing, and highlighted credit risk and cybersecurity as key focuses.

- **Lending rules.** When asked about the OCC’s fair access rule, which would have restricted banks from making lending decisions based on ESG factors, Hsu said that he had no intention to revisit it after its publication was paused in January. On the true lender rule, which the Senate voted to overturn last week, Hsu said a review is ongoing while the agency waits to see if the House will complete the Congressional Review Act process and fully reverse the rule.
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In his first hearing as Acting Comptroller, Hsu made it abundantly clear that he has a full plate and is ready to begin turning the OCC in a new direction. Unsurprisingly given that he is in his second week of what may be a temporary stewardship, it appears that he will oversee a great deal of review and preparation for future action. Although new rule proposals are therefore likely some time away, we can see from this hearing some indication of the form they will take. For example, his commitment to work with the Fed and FDIC on a single CRA rule makes it likely that the OCC’s review will move its rule closer to the Fed’s proposal. However, it may still be difficult to achieve the industry’s goal of a unified rule from the three banking agencies if Trump appointee Jelena McWilliams substantially disagrees with their approach. On both cryptocurrency and fintech charters, Hsu’s remarks signal a more careful approach than his predecessors, with greater focus on risk management and consumer protection.

Hsu’s commitment to prioritize climate risk also comes as little surprise given that he was selected by Secretary Yellen and her efforts to coordinate climate policy through the FSOC - of which Hsu now serves as a member - has been emboldened by yesterday’s EO. We can expect the OCC under Hsu, and likely any new Biden appointee, to align with Treasury, the Fed, the SEC and the CFTC by dedicating resources and attention towards initiatives to address climate risk. It may take some time for these initiatives to filter down to the examiner level, but OCC-supervised banks should expect to eventually answer questions about how they have integrated climate concerns into their enterprise-wide risk management and governance.

3. Fed Chair Powell speaks on payments innovation and CBDCs

Yesterday, Fed Chair Jerome Powell released a statement focusing on technological innovation in payments and the potential development of a US central bank digital currency (CBDC). After highlighting actions the Fed has taken to address innovation in the payments space including its announcement that it will develop a real-time payment system (FedNow) by 2024, he turned to recent innovations related to digital ledger technology (DLT). Powell explained that cryptocurrencies have shown too much price volatility to be effectively used for payments, and while “stablecoins” (i.e., digital assets tied to value of the dollar or another currency) have attempted to address this issue, they lack deposit insurance and other protections associated with central bank-issued currencies. To address risks stemming from these innovations, he noted that the Fed must increase its attention to the appropriate oversight and regulatory framework for digital assets.

He also explained that the Fed has been researching innovations in DLT and digital assets while determining whether to issue its own CBDC that would be available to the general public. In particular, he noted that the Fed’s focus is on (1) whether a digital dollar could improve upon the existing payments system and (2) how to design an approach that would complement rather than replace cash and bank deposits. To help stimulate public conversation on the topic, it will release a discussion paper this summer that outlines its current thinking and requests input on a variety of topics including financial inclusion, consumer protection, data privacy and security.

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CBDC research and development has been underway for some time now, with PwC’s CBDC Global Index highlighting that more than 60 central banks are at different stages in the process and are pursuing a number of different design options. In contrast with some central banks that have live pilot programs in place such as China and Sweden, the Fed has thus far taken a wait-and-see approach that focuses on conducting research while giving few details as to what a digital dollar might look like. His speech this week, however, provided a rare glimpse into the Fed’s current thinking on some of these details, noting that a potential CBDC would be available to the general public (as opposed to a wholesale CBDC limited to interbank settlement). By stressing that the Fed will attempt to complement rather than replace the existing payments system, Powell is addressing concerns that a US CBDC issuance would reduce deposits at banks, which could reduce liquidity in the financial system. As he also notes that financial inclusion will be a factor in its design, we could see a model where banks and other financial institutions generally provide CBDC custody services with some limited direct Fed-issued wallets targeted toward the unbanked and underbanked.
While we will learn much more about the potential US CBDC design with the Fed’s upcoming discussion paper this summer, any eventual release will take some time. Although the release is not imminent, firms should consider taking the opportunity to begin taking steps to evaluate their current capabilities, design a digital asset strategy, and develop the appropriate skills to prepare for a potential CBDC release. Doing so will allow them to prepare for the launch of CBDCs by other major economies, which could come as early as next year, and leverage their enhancements to support cryptocurrency and other digital assets.

For more information, see our Regulatory Brief, The Evolution of Money: Why Financial Institutions Should Start Paying Attention to CBDCs.

4. SEC focuses on cyber reporting

The SEC last week assessed a $1.5 million fine against a broker-dealer for failing to file Suspicious Activity Reports (SARs) relating to cyber events. According to the SEC’s order, over a three year period the broker-dealer was aware that bad actors gained access to customer accounts by using improperly obtained personal identifying information of customers and were in possession of electronic login information such as usernames, email addresses, and passwords. The order stated that the broker-dealer failed to file approximately 130 SARs and the nearly 300 SARs that it did file did not include the “five essential elements” of information (i.e., who?, what?, when?, where? and why?) that it was required to report, including cyber-related data such as URL addresses and IP addresses.

The Treasury Department’s Financial Crimes Enforcement Network (FinCEN) requires that financial institutions file SARs related to any “cyber event” that puts an aggregate of $5,000 at risk and has defined a “cyber event” broadly as any attempt to compromise or gain unauthorized access to electronic systems or information. Last year, FinCEN issued two additional cyber notices related to ransomware and exploiting the Coronavirus (COVID-19) Pandemic, and earlier this year the SEC released a notice reminding institutions of their obligations to provide completeness of information when filing cyber SARs.

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Annual examination priorities published by regulators have consistently listed cybersecurity among their areas of focus, but with recent high-profile cyber crimes such as the Colonial Pipeline ransomware hack that caused gas shortages throughout parts of the US as well as President Biden’s recent Executive Order on cybersecurity, we expect scrutiny to increase. Judging by recently-confirmed SEC Chair Gary Gensler’s track record of strict enforcement from his previous role as CFTC Chair, he does not appear likely to let firms off the hook for inadequacies in their cybersecurity responsibilities. The SEC’s order itself serves as a reminder that checking the box and filing SARs is not enough - the agency will be scrutinizing filings for quality of information. In response, firms should make sure that their cybersecurity and reporting teams are working to include appropriate data in SAR filings - and now is a good time to train or refresh staff on meeting the SEC’s reporting expectations.

For more information on the recent Executive Order, see PwC’s recent publication, Biden’s executive order on cybersecurity: A good beginning.
5. On our radar: These notable developments hit our radar over the past week:

- **Developments in the transition away from USD LIBOR.**
  - **ARRC selects CME as future SOFR term rate administrator:** Following an RFP process, the Alternative Reference Rate Committee (ARRC) on Friday announced the selection of the CME Group as future administrator of a forward-looking SOFR term rate. The ARRC has not yet formally recommended a SOFR term rate, as that recommendation remains dependent on continued progress against a series of market indicators the committee published earlier this month. While the CME launched their forward-looking SOFR term rate (for limited use in cash products) earlier this year, a formal ARRC recommendation of a term rate is important in the context of its recommended fallback language for cash products, which stipulates an ARRC recommended term rate as the first replacement option at the point of USD LIBOR’s cessation.

- **LIBOR transition: Not only for big banks.** On Monday, the National Credit Union Administration (NCUA) issued a supervisory letter on the evaluation of LIBOR transition plans at federally insured credit unions. The guidance aligns closely to the Fed’s supervisory guidance on LIBOR transition preparedness for institutions with less than $100 billion in assets issued earlier this year. Examination criteria include institutions’ transition plans, financial exposure measurement, operational preparedness, contract management, communication with counterparties and members, and transition oversight. Consistent with interagency guidance released at the end of last year, the NCUA highlights the importance for institutions to stop the use of LIBOR in new contracts as soon as possible, and no later than December 31, 2021.

  *Subscribe to PwC’s LIBOR Transition Market Update [here](#) to read more about these and other developments.*

- **FSOC to discuss LIBOR transition and money market fund reform.** Treasury Secretary Janet Yellen announced that the FSOC will meet on June 11, with the preliminary agenda for the open session including the transition away from LIBOR and money market mutual fund reform.
Additional information

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