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Acting Comptroller Hsu recommends new metrics to trigger FSOC review

Initial perspectives related to remarks by the Acting Comptroller of the Currency, Michael J. Hsu

On February 21, 2024, the Acting Comptroller of the Currency, Michael J. Hsu, delivered a speech at Vanderbilt University where he outlined his perspective on the financial stability implications associated with the blurring of banking and commerce, in particular payments and private equity/credit.[1] In his prepared remarks, Hsu recommended FSOC establish new metrics to trigger systemic risk review and called on Congress to create a federal framework for payments regulation. The speech follows the Financial Stability Oversight Council's (FSOC) recently updated regulatory framework for nonbank financial companies (NBFCs) and the Consumer Financial Protection Bureau's (CFPB) proposed rule for federal oversight of digital wallets and payments providers.

5 insights you should know

Payments and private equity in focus: In his remarks, Acting Comptroller Hsu telegraphed to the market the Office of the Comptroller of the Currency's (OCC) systemic risk priorities, focusing on payments and private equity (PE). This increased regulatory focus follows recent amendments to FSOC's analytic framework which specifically stated its authority over payment, clearing and settlement activities, and financial market utilities.

Recommendation for a new "trip wire" approach: Acting Comptroller Hsu recommended that FSOC establish a set of metrics and thresholds, which if exceeded would trigger FSOC to assess the underlying trigger for systemic risk and potential NBFC designation. Under Acting Comptroller Hsu's recommendation, each assessment would then be conducted on its own merits, irrespective of the "trip wire" that triggered the review.

Call for a national money transmitter licensing framework: Acting Comptroller Hsu remarked that he believes the lack of a federal money transmitter regime acts as a regulatory gap that should be filled by Congress to create a federal framework for payments regulation. In contrast to many peer countries, the US lacks a national money transmitter licensing standard and authority, with regulation and supervision comprised of a patchwork of varying state-by-state standards and practices.

Increasing regulatory focus on payments innovations: While payments have historically been dominated by banks, the use of innovative technologies by nonbanks has led to increasing competition, with some fintechs blurring the lines by offering deposit-like activities, such as providing customers the ability to deposit paychecks directly into their account, earn yield, and access credit. These type of activities will likely draw the most regulatory scrutiny because of their vulnerability to create run risks.

Regulatory scrutiny continues to be focused across nonbank types: While the focus of Acting Comptroller Hsu's remarks were on payments and private equity, the recommended new "trip wire" approach to FSOC review could be used for a wide-range of financial activity, including mortgage servicing and hedge funds. During the question-and-answer segment, Acting Comptroller Hsu reiterated that hedge funds continue to be on FSOC's radar.

5 considerations to evaluate

1

Prepare for potential NBFC designation: The Acting Comptroller's speech, along with recent amendments to FSOC's designation guidance and CFPB's proposal to supervise digital wallet and payment providers, illustrates regulators' growing interest in expanding federal oversight over NBFCs. The growth of less-regulated PE and private credit industry, and their interconnectedness with banks, have heightened financial stability risks, which may prompt FSOC designation.

2

Monitor potential thresholds and prepare for regulatory engagement: NBFCs whose activities may be subject to FSOC review should carefully monitor market activity metrics and align monitoring activates with potential "trip wire" thresholds. Institutions should do their own independent analysis of their systemic footprint ahead of any potential designation and be prepared to answer detailed questions from regulators, if they are prominent in covered markets.

3

Potential uniform standards for payment service providers: A national money transmitter framework could provide more uniform standards for multistate payment service providers, whose current licensing and oversight at the state level may vary greatly. Market participants should also closely monitor federal legislative efforts on payment stablecoins to understand how those regulatory developments may intersect with potential federal oversight of money transmitters

4

Review fintech partnerships and third-party risk management: The blurring of bank-like services will likely attract more supervisory scrutiny in areas where bank regulators can oversee and influence nonbank activities, such as banks' fintech partnerships and third-party risk management (TPRM) capabilities. Banks should evaluate their TPRM framework and prepare for increased regulatory oversight of nonbank partnerships, such as banking-as-a-service (BaaS).

5

Prepare to demonstrate risk management capabilities to regulators: Regulators continue to focus on the stability risks posed by NBFCs and seek to fill in information gaps. Therefore, NBFCs may consider proactively engaging with regulators to demonstrate their risk management capabilities are robust and well-developed to effectively manage risks and preserve financial stability.

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[1] Office of the Comptroller of the Currency (OCC), Acting Comptroller of the Currency Michael J. Hsu, "Preventing the Next Great Blurring," February 21, 2024.

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Analysis of financial stability risks associated with the blurring of banking and commerce

Financial activity	Acting Comptroller of the Currency, Michael J. Hsu's risk assessment
Payments	• In the past 10 years, a wide range of **nonbanks have leveraged technology to compete in the payments sector**, driving the growth of the digital economy with innovations like peer-to-peer payments, "smart" point-of-sale terminals, and automated B2B payments. • We are likely going to see even more change in the payments space in the next 10 years, as **open banking and real-time payments are likely to further accelerate digitalization** trends in banking. • Some fintechs, which initially focused on facilitating payments, later moved into adjacent activities, blurring the line between banks and nonbanks and **raising concerns about level playing fields** (e.g., offering customers the ability to deposit paychecks directly into their accounts, earn yield on deposited cash, and access to credit). • From a financial stability perspective, the **deposit-taking-like activity of nonbanks warrants the most scrutiny** because of the vulnerability it creates to runs, if those customers have doubts about the safety of their money. • However, **significant data gaps remain due to the lack of standardized data**, making it difficult to compile and compare the amount of money nonbank companies manage for their customers.
Private equity/credit	• PE funds have historically focused on equity, rather than debt, keeping them relatively removed from the business of banking. • However, the landscape is evolving: **interactions and exposures between banks and PE firms have grown** (e.g., through capital call facilities) and PE firms have expanded aggressively into private credit (estimated to exceed $1.5 trillion globally as of 2022). • The **shift of PE into private credit is significant** because it involves nonbanks originating and holding loans at scale—an activity traditionally done by banks. • Moreover, the closed-end fund structure of PE funds is undergoing changes, such as the advent of evergreen funds which offer investors early exit options. Such structures, however, can introduce new risks, including redemption risks similar to those encountered by open-end bond funds. • PE firms have increased their holdings of insurance companies, some of which have also established offshore reinsurance companies to support their insurance activities and to serve as holding companies for affiliates. **Since PE firms are not subject to consolidated supervision, it is challenging for regulators and external observers to evaluate the risk levels and interdependence of these activities.**

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