

Keynote Address by Deputy Secretary Muzinich TCH + BPI 2019 Annual Conference

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Good morning. Thank you Greg for the introduction, and for putting together this event. It's great to be here, and I'm looking forward to discussing some of Treasury's priorities.

I would like to break my remarks today into three parts, all of which are relevant to financial institutions, though from different perspectives. The first will address Treasury's focus on economic growth through regulatory and tax reform. The second will examine the intersection of economic policy and national security. And the third will include a discussion of the emerging landscape of financial services and digital currencies.

1. **ECONOMIC GROWTH**

Financial Regulatory Reform

I'll start with a discussion of regulatory reform, which has been a big part of our growth agenda. Over the last two and a half years, Treasury released six reports on recommended regulatory changes. I am often asked about how much progress has been made on these recommendations. So let me give you a sense. We proposed about 370 regulatory changes, and Congress and the regulators have acted or are acting on about 60%. I'll highlight a few areas.

First, we spent a lot of time on a bipartisan banking reform bill known in Washington as S.2155, which became law last year. This legislation incorporated a number of our proposals and was an important step in tailoring regulation based on the size and complexity of an institution.

Building on this legislation, the banking agencies finalized rules for applying enhanced prudential standards to U.S. and foreign-owned banks. The rules implemented S. 2155's requirement that prudential standards be applied to firms based on risk. They established a new four-category framework in which firms with the largest size and greatest complexity (known as Category I and II firms) remain subject to more stringent standards while smaller and less complex firms (known as Category III and IV firms) are subject to less stringent standards.

In addition, The Volcker Rule has been reformed. S. 2155 generally exempted community banks with less than \$10 billion in assets from the rule. This October, the five Volcker Rule writing agencies simplified the rule by adjusting the definition of proprietary trading and further tailoring the compliance regime for larger banks.

Overall, we commend the agencies for their thoughtful approach to these and other rules. We now have a banking system which supports economic growth and has greater capacity than a decade ago to function in stressful times.

Tax Reform

In addition to regulatory reform, we have also used tax reform to stimulate growth. In 2017, with the passage of the Tax Cuts and Jobs Act, we achieved the first major re-write of the U.S. tax code in three decades. The new tax code is designed to deliver tax relief to all Americans and especially middle-income households, which we achieved through lower rates and expanded credits.

However we didn't only want to decrease the tax burden, we also wanted pretax wages to increase. Rising wages are key to achieving desirable distributional outcomes, since wages, rather than earnings from asset ownership, are the main source of income for many Americans. Unfortunately, over the previous decade wage growth had been very low by historical standards.

Our diagnosis of a key reason wages weren't rising was that productivity growth had slowed. As this group will understand, capital investment is a driver of productivity growth. Unfortunately, net investment in real capital stock weakened from 2008 to 2016, slowing to 1.1 percent annual growth from a post-World War II average of 3.2 percent. In other words, low capital investment was leading to low productivity growth, which, in turn, was leading to low wage growth.

To address these deficiencies, tax reform adopted a number of policies to make the United States a more attractive place to build businesses, including: lowering the corporate tax rate

from 35 percent to 21 percent; moving from a worldwide to a territorial tax system; and allowing for immediate expensing of capital equipment.

Results

These efforts to reform financial regulations and taxes were undertaken to strengthen the U.S. economy, and, while it is early, we are happy with the results.

We have seen substantial growth in business investment. Since tax reform enactment, intellectual property investment has grown at an annual rate of 7.8% vs. 4.9% over the previous four years. Research and development spending has grown at 6.7% vs. 3.5%.

Consequently, productivity has increased, facilitating wage growth without high inflation.

Real hourly wages grew 1.9 percent for the 12 months ending September 2019. This compares to 0.4 percent for the period 2009 to 2016. Compounding wage growth closer to 2% than half a percent over time will make a substantial difference in the lives of Americans.

This success is also seen across a number of metrics beyond the investment, productivity, and wage growth story. When we came into office, the Congressional Budget Office projected that we would add about 25,000 new jobs per month in 2019. For the past twelve months, we have added on average 174,000 jobs per month.

Unemployment remains at 3.6 percent. Unemployment rates for African Americans, Hispanic Americans, and women are at or near all-time lows.

In addition, more disabled Americans are working than ever before, and over 7 million Americans have been lifted off food stamps since the election. Economic growth is improving the lives of some of the most vulnerable Americans.

2. ECONOMIC POLICY AND NATIONAL SECURITY

Let me now turn to another area of Treasury's responsibilities, the intersection of economic policy and national security. While Treasury's role in national security is not always well understood, it is something the Secretary and I spend enormous amounts of time on. I will highlight three tools we rely on, given their importance to financial institutions.

Sanctions

The first is sanctions, which are very much at the forefront of foreign policy today. They are a key tool in Venezuela, Iran, North Korea, Syria and other places. They are an extremely effective means of denying resources to bad actors, and allow us to advance national security without putting our military at risk. I won't delve into individual country programs here, but let me just emphasize that we have an extremely thorough process for identifying and vetting sanctions targets, and that I have been enormously impressed with the talented career officials who administer our sanctions program.

I would also like to emphasize that financial institutions are a very important part of the sanctions process. As OFAC issues new sanctions, we rely on the private sector to quickly and effectively implement them. By blocking funds or rejecting transactions, financial institutions drain resources from dictators, nuclear proliferators and human rights abusers. When we add a name to our designation list, and the private sector adds that name to its filters, our country is safer.

Committee on Foreign Investment in the United States (CFIUS)

The second national security tool I'll highlight is CFIUS. Foreign direct investment represents a significant component of our economic landscape, standing at well over \$8 trillion in 2018, and supporting over 7 million jobs. However, some foreign investment may pose national security risks. Treasury addresses these risks through CFIUS, which is authorized to review foreign investment for national security purposes. This is a critical tool, especially given the emergence of new technologies like 5G, quantum computing, and AI, which bring many benefits but can also be used against us in the wrong hands.

In fact, last year we worked with Congress to pass a new bipartisan law expanding CFIUS' jurisdiction, allowing us to screen more deals for national security risks.

It is worth noting that along with strengthening CFIUS, we have been running the review process more efficiently. We want to ensure that safe investments can be made easily and expeditiously in the United States. The best proof of this is in the data. Treasury does not routinely release aggregate case data, but the investment community should know that twice as many cases are clearing during the first stage of review as compared to a year ago. When there are no national security risks, we are letting the parties know quickly, so that they can proceed with their transactions. The United States remains very much open to foreign investment.

AML and Beneficial Ownership Reform

A final national security tool I'll highlight is our anti-money laundering regime. Although we have one of the strongest AML regimes in the world, we recognize the need to modernize and reform. We are taking a hard look at both the Bank Secrecy Act and our broader AML approach. In particular, we must make sure financial institutions are devoting their resources towards high value activities and are encouraged to innovate.

As part of our AML efforts, we are also committed to beneficial ownership reforms. The U.S. is one of only a few countries where it is possible to set up an anonymous shell corporation, without disclosing the underlying ownership. Treasury believes we must address the current gap in our system so that the ultimate owners of companies are identified at the time of company formation. Doing so will discourage the use of shell companies to disguise illicit funds, preventing terrorist financing and other serious crimes. The key to getting this done will be finding a solution that protects national security, while not creating a burden for small businesses, and also allowing for the maintenance of privacy. We continue to work closely with Congress on effective bi-partisan legislation.

3. **EMERGING LANDSCAPE OF FINANCIAL INTERMEDIATION AND DIGITAL CURRENCIES**

Finally this morning, I would like to address some of the broader innovation trends that are shaping our banking and financial system.

While banks today provide a range of financial services through financial holding companies, banking, as traditionally understood, has typically provided for the offering of several bundled core activities: the moving, storing and lending of money; or, in other words, the provision of payments, deposits, and credit.^[1]

Technology is re-shaping each of these activities. For instance, internet business models allow the acquisition of customers without branch networks, as well as the rapid aggregation of customer data by new entrants. This has allowed the emergence of competitors that provide products and services on a standalone “unbundled” basis, as opposed to the more traditional bundled offering. Consider payments, deposits and credit in turn.

Payments are increasingly being facilitated by non-bank front-end products such as Apple Pay and Venmo. While the underlying payment rails continue to be provided by banks, even the blockchain is emerging as a theoretical alternative to centralized payment settlement. Activities resembling deposit-taking are being performed through front-end services offered by non-banks, such as Paypal or SoFi, which store value for customers. Finally, credit is now being extended by a variety of online lenders without a branch network or affiliated deposit base, such as OnDeck & Lending Club.

Ironically, firms may build a customer base through one product line like payments and re-bundle functions like lending over time. This is an interesting parallel to another trend, of online retailers opening or acquiring physical storefronts due to consumer demand.

Technology-based business models compete with existing businesses, and then may start to look like traditional businesses in the products they offer.

We welcome responsible innovation from a public policy perspective. It leads to more choices for Americans, and makes incumbent businesses better too. Banks, for instance, are clearly embracing new technology solutions themselves. However, this innovation also raises interesting public policy questions, such as:

1. how regulation should apply to these unbundled activities; and
2. second, how regulation should be modernized to allow banks and non-banks to take advantage of new trends in technology.

Treasury addressed these sorts of questions in our Fintech report last year. We recognize that there is no way to fully future-proof our regulatory system and tackling these policy challenges will require ongoing work. But one area I would like to focus on is payments, and more specifically cryptocurrencies. Cryptocurrency projects in recent years differ from other trends in innovation in that they not only have implications for private business, but also for a number of activities the government is responsible for.

Consider for instance national security. One of the issues at the top of Treasury's mind is that digital currencies can potentially be used to evade existing legal frameworks—like those governing taxation, anti-money laundering, and countering the financing of terrorism. Treasury has made it clear that the obligation to comply with US laws is the same regardless of whether a

transaction is denominated in traditional fiat currency or digital currency. Existing laws apply to digital assets in no uncertain terms. However, if a cryptocurrency allowing anonymous transactions were to grow to scale, enforcing laws that prevent crime and terrorist financing could be more difficult.

Even if we could be assured that the private sector is complying with the letter and spirit of AML laws, there are important remaining concerns that government must consider, such as a digital currencies potential effects on the monetary base, financial stability, and user protection and privacy. In addition there is a longer term concern about what I will governance.

Some historical context is helpful here. In the 1830s, 90% of currency in the U.S. was issued by various private participants.^[2] Such a multi-currency system was ultimately rejected as a way to organize our domestic financial and monetary system. The U.S. enacted laws to charter national banks to create a uniform currency; a central bank to provide a flexible and stable monetary system: and federal deposit insurance. Together these form key foundations of our financial system.

We settled on our existing structures when officials, accountable to the democratic process, made decisions about the right path for the country. If a cryptocurrency checked all the near term regulatory boxes today and grew to scale, what would be the process for making changes to rules governing the currency in the future? For instance, if a decade from now there were a desire for a stablecoin to go from fully reserved to partially reserved, or to shift its underlying mix of reserve currencies, would that decision be made by a private governing association? Or by a majority of coinholders? What if foreign actors had acquired a majority of the coins? In any case, would important decisions about our economic system have been taken out of the hands of representatives accountable to the people?

We value innovation and welcome efficiency improvements. However, decentralized privately-issued digital currencies are not simply a means of payment, but, depending on their structure, can shift some functions traditionally performed by government to the private sector. Digital currencies at scale raise not only concrete questions about money laundering, monetary policy, and other topics, but also very abstract questions about self-government. Those engaged in digital currency markets should therefore expect that policymakers, in pursuing the public interest, will take a very hard look at these issues.

Conclusion

To conclude, let me again thank you for having me today. The topics of growth, economic national security, and technological innovation matter to financial institutions, to the U.S. Treasury, and to the public as a whole. We look forward to a continued robust dialogue as we take our country into the future—vigilant of risks, but confident in the power of free markets and free people to build a better world.

Thank you.

[1] Banks uniquely provide deposit accounts that are payable on-demand at par, which enables the settlement of payments for the rest of the financial system and economy. And, while our financial system has evolved, banks remain central to monetary policy and the creation of money in the form of deposits. To provide such on-demand deposits, a bank must necessarily engage in maturity transformation because it issues a liability that is payable on-demand but invests in assets with longer maturities. The net result is banks have served three highly interrelated functions (deposit taking, payments, and credit extension). Hence we may refer to banking as bundled.

[2] https://www.stlouisfed.org/~media/files/pdfs/bullard/remarks/2019/bullard_cebra_new_york_19_july_2019.pdf?la=en