U.S. DEPARTMENT OF THE TREASURY

Remarks by Assistant Secretary for Financial Institutions Graham Steele Before the Exchequer Club of Washington, D.C.

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As Prepared for Delivery

Good afternoon. It's a pleasure to be here today, to join this esteemed group and to see so many familiar faces. I'm particularly thankful to Margaret and Bridget for the invitation.

I'm honored to join a distinguished list of current and former Treasury officials who have spoken at the Club, including Treasury Under Secretary Gary Gensler in 2000 and Treasury Assistant Secretary Michael Barr in 2009.

Because new payment and investment technologies are rapidly changing the way consumers and investors interact with financial products and payments, today I will be discussing Treasury's financial institutions agenda with a focus on our recent work on fintech and Big Tech, crypto-assets, and cloud service providers.

NON-BANKS/FINTECH

I'd like to start with the Department's work regarding non-bank firms involved in financial services, including fintech and Big Tech firms.

Participation by non-bank firms in financial services is a key priority area for Treasury right now. In November, we published a report assessing the impacts of new entrant non-bank firms on competition in consumer finance markets, in response to President Biden's Executive Order on Promoting Competition in the American Economy.[1] We found, unsurprisingly, that the banking industry has grown more concentrated over time. There are opportunities for market participants to improve the accessibility and delivery of financial services.

New entrants are taking advantage of this opportunity by diversifying and adding competitive pressure to consumer finance markets. However, new entrant non-bank firms have largely not been subject to the kind of comprehensive regulation and supervision to which banks are subject. As a result, the growing role of these firms in financial markets – and the benefits they could provide – are accompanied by numerous risks, including risks related to regulatory arbitrage, data privacy and security, bias and discrimination, and consumer protection, among others.

Treasury's report makes several recommendations, primarily focused on the use of existing authorities by the federal banking regulators and the CFPB to achieve better-coordinated supervision of bank-fintech partnerships and banks' risk management of new credit underwriting models. The report also supports federal agencies' ongoing efforts, including the review of bank merger policies by federal banking regulators and the Justice Department; increased antitrust scrutiny of the tech and financial services sectors by competition authorities; the CFPB's inquiry into Big Tech payment platforms and Buy Now, Pay Later (BNPL) providers; and the CFPB's rulemaking efforts to address consumer financial data access through implementation of section 1033 of the Dodd-Frank Act.

Consistent with the President's Executive Order on fostering competition, the report also examines concerns related to the entrance by Big Tech into financial services. Big Tech firms have generally sought to enter consumer finance markets through relationships with banks and third-party fintech firms. By not directly offering banking services, BigTech firms have avoided the prudential regulation and supervision that would apply if they sought to offer those services directly.

This presents a trade-off. On the one hand, new entrants and new partnerships may be able to contribute to a more competitive, innovative, and inclusive financial services landscape.

But on the other hand, as firms expand their efforts to embed finance into e-commerce platforms, several concerns arise. With non-banks providing bank-like services, but without the safety and soundness, consumer protection, and risk management that prudential regulation and supervision provide, there may be risks to individual users or to the financial system more broadly. Further, these firms' potential to scale rapidly, due to network effects and strategic complementarities, could result in increased market concentration. The structure of our retail payment systems offers some benefits by providing customers with choices, and if one system is unavailable, other failover options are available. Reducing these redundancies and increasing concentration could be worse for customers and for the financial system.

There are also risks analogous to the age-old concerns regarding the mixing of banking and commerce. Reasons for the historical separation in the United States of banking and commerce include preventing conflicts of interest, avoiding excessive concentration of economic power, and limiting contagion between affiliates – where the failure of a commercial platform leads to impairment of the safety and soundness of the affiliated bank. Big Tech's involvement in financial services presents many of these historical issues, in addition to novel banking and commerce concerns. For example, Big Tech firms may have incentives to leverage their existing commercial relationships, consumer data, and other resources to enter new markets, expand their networks and offerings, and scale rapidly to achieve capabilities that others—including depository institutions—do not have and cannot replicate. They may be able to use data advantages, network effects, acquisitions, predatory pricing, and other tactics to gain or entrench their market power to the detriment of competition and, ultimately, consumers.

While many of these issues are still emerging, we are watching them closely and engaging with our partners across the Administration and at the regulatory agencies.

CRYPTO ASSETS

I'll now turn to a more specific financial technology sector, and Treasury's work on crypto-assets. Treasury is working to promote a fairer, more inclusive, and more efficient financial system; to mitigate risks to financial stability; to protect consumers, investors, and businesses; and to prevent risks to national security, including from illicit finance. To achieve these goals, we work to understand the opportunities and risks of these financial products, and how they can impact all Americans.

As many of you know, Treasury and interagency groups we work with have published several reports regarding digital assets. I'll touch on some key themes from those reports.

First, in late 2021, the President's Working Group on Financial Markets (PWG), along with the FDIC and OCC, published a report on stablecoins used for payments.[2] Stablecoins have the potential to scale rapidly, in part due to network effects and strategic complementarities. Due to the role stablecoins could potentially play as a replacement for other more traditional forms of payment, they raise concerns related to detrimental effects on competition; excessive concentration of economic power; and systemic risk.

Recent events have again demonstrated the inadequate oversight of stablecoins. Many stablecoins involve private guarantee arrangements that are a hallmark of shadow banking.[3] The experience last year with the stablecoin Terra shows how investors are harmed from runs on nominally stable assets. As we saw, the run on Terra began with a series of large withdrawals.[4] To meet withdrawals, an issuer may have to sell assets quickly, leading to a fire sale dynamic that diminishes the value for remaining investors. Past examples have shown us that early redeemers, which tend to be experienced investors with the most advanced technological access to sell quickly, use their first mover advantage to redeem at the first sign of issues, leaving less-experienced retail investors to bear the brunt of the losses.[5]

The PWG made recommendations to address these and other risks. The report's main recommendation is for Congress to enact legislation to ensure that stablecoin issuers are subject to a robust prudential regulatory framework, in contrast to the light-touch regimes that we have seen emerge. Among other things, such a framework would mitigate risks to financial stability and reinforce the separation of banking and commerce by limiting the ability of commercial companies to issue stablecoins.

More recently, in the fall of 2022, Treasury published a series of reports in response to President Biden's Executive Order on Ensuring Responsible Development of Digital Assets.[6]

The Financial Stability Oversight Council (FSOC), which the Secretary of the Treasury chairs, published a report in October 2022 that examined the potential financial stability implications of crypto-asset activities.[7] The FSOC report noted that while crypto-asset activities have not yet achieved the scale or interconnectedness to pose financial stability risks, they could eventually pose such risks if they are not subject to appropriate regulation and enforcement. The report noted many risks associated with crypto markets, including volatility, leverage, opacity, vertical integration, operational risk, inadequate governance, and noncompliance with applicable regulatory regimes. Many of these issues have come to light during recent market events and bankruptcies. The FSOC report also made recommendations to address key financial stability risks of crypto-assets.

Taken together, these reports highlight several gaps in existing authorities over crypto-assets. These include, notably:

- The vulnerability of unregulated stablecoins;
- The limited authority over spot markets for crypto-assets that are not securities; and
- The need for greater visibility into the activities of all of the affiliates and subsidiaries of integrated crypto entities.

Elsewhere, we have noted the need for a more comprehensive payments regulatory framework.[8] One can imagine scenarios in which the confluence of these gaps becomes particularly troubling—for example, where a large and lightly regulated payment company elects to issue its own lightly regulated stablecoin.

In September 2022, Treasury issued a report titled Crypto-Assets: Implications for Consumers, Investors, and Businesses.[9] The report reviews crypto-asset markets and the risks and opportunities they might present to U.S. consumers, investors, and businesses. We noted that consumers, investors, and businesses are exposed to conduct, operational, and intermediation risks, and risks from regulatory non-compliance. These factors contribute to frequent instances of operational failures, market manipulation, fraud, thefts, and scams. There are also unique risks associated with these offerings, such as data privacy and security risks, cost structure concerns, and other risks related to new forms of discrimination and unfair and deceptive acts and practices.

In particular, we noted in the report that some companies market their products as safe and deposit-like when they are nothing of the sort. The FDIC and CFPB have taken action against false and misleading statements regarding the availability of deposit insurance, but widespread confusion remains. Moreover, as seen in recent bankruptcies, crypto firms may be engaged in exceptionally risky behavior, and holders of crypto-assets may not understand the potential for the loss of their investments.

We also focused on the claims that crypto-assets can advance financial inclusion. While there is limited data on the crypto-asset use and experience of populations vulnerable to disparate impacts, available evidence suggests that the potential financial inclusion benefits of crypto-assets largely have yet to materialize, due to factors including extreme price volatility, the need for access to an account with a depository institution, and high transaction fees. Further, crypto-asset products may present increased risks to populations vulnerable to disparate impacts, including creating new forms of fraud and scams, predatory inclusion, and surveillance and data gathering. In short, while some have argued that digital assets could improve access to financial services for financially underserved communities, that vision has not materialized. In fact, at this point, it would appear that for some investors participation in crypto-assets could contribute to exacerbating existing inequities.[10]

A consistent theme across the three reports that I have mentioned is that the United States has strong investor and consumer protection laws that address many of the risks posed by digital assets. Where existing laws and regulations apply, they must be enforced vigorously so that crypto-assets and services are subject to the same protections and principles as other financial products and services. There is an urgent need for action to protect consumers, investors, and businesses, even as stakeholders and policymakers formulate legislative proposals for comprehensive regulation of crypto-assets.

While consumers and investors have suffered meaningful and unnecessary harms during the crypto-asset market volatility, so far crypto-assets have not undermined U.S. financial stability more broadly. That is due in large part to the federal banking agencies taking a careful and cautious approach.

We have certainly observed some connections between banks and crypto-asset firms that raise concerns. For example, Alameda Research Ventures LLC, an affiliate of FTX, made a substantial investment in a very small community bank that resulted in the bank’s assets growing five-fold, with funds from Alameda and its related entities accounting for a significant percentage of the bank's deposits.[11] In addition, a recent FDIC report indicates certain crypto-asset firms are placing runnable deposits at banks under more permissive terms than had previously been permitted.[12]

To limit the regulated banking system's exposure to unregulated crypto-assets, the banking agencies recently issued a joint statement regarding the risks of crypto-asset activities and banks' obligations to ensure that such activities are conducted in a safe and sound manner and consistent with prohibitions against unfair, deceptive, or abusive acts and practices.[13] In addition to reinforcing these foundational banking principles, the agencies also noted that issuing or holding as principal crypto assets that are issued, stored, or transferred on an open, public, or decentralized network is highly likely to be to be inconsistent with safe and sound banking and warned against concentrated exposures to the crypto-asset sector.

These concerns are not about whether investors are allowed to participate in crypto-markets – it is a question of how we maintain the safety and soundness of banking institutions in the context of certain extremely volatile financial products. In my view, the agencies' statement is a timely and well-founded response to the recent events in the crypto-asset markets.

CLOUD ADOPTION REPORT

Finally, I'd like to highlight our cybersecurity work related to cloud adoption in the financial services sector.

Cybersecurity is a significant focus for the entire federal government and is a particular priority of mine, as I oversee Treasury's Office of Cybersecurity and Critical Infrastructure Protection and am chair of the Financial Banking and Information Infrastructure Committee (FBIIC). The FBIIC, whose members represent the state and federal financial regulatory agencies, is our primary mechanism for disseminating cybersecurity information to the U.S. regulatory community.

As part of the FBIIC's ongoing review of cybersecurity trends and issues in the financial sector, Treasury, in collaboration with FBIIC members, released a report on February 8th that examines how the current and future use of cloud services across the financial sector may impact the sector's operational resilience.[14]

As the report acknowledges, there can be significant advantages of cloud services, including reduced costs; the ability to rapidly deploy new forms of information technology; a shorter time to develop new products and services; and enhanced capabilities for security and resilience.

Our report also describes gaps reported by many of the firms interviewed by Treasury. Specifically, the report highlights some of the key challenges of increased cloud adoption. Let me note three of these concerns. One is insufficient transparency to customers pertaining to operations and operational incidents at cloud service providers (CSPs). A second is unequal dynamics in cloud contract negotiations, which can particularly affect smaller firms. The third is the potential impacts that market concentration among CSPs could have on exposures to operational risk and general sector-wide resilience.

Treasury is committed to enabling the financial services sector to realize the potential benefits of cloud services in a safe, secure, and responsible way. To that end, over the course of 2023 and 2024, Treasury will work with the FBIIC, FSOC, CSPs, and the financial sector to attempt to resolve the gaps identified in the report through a newly established Cloud Services Steering Group. The steering group will coordinate on issues raised in the report and promote coordination more broadly, including with respect to federal agencies' examinations and information sharing, while working with the private sector to bolster transparency at CSPs.

Similar to the findings in Treasury's non-bank competition report, we are particularly focused on the ability to monitor financial institutions' third-party relationships and the concentration of segments of the cloud services market among three CSPs.

CONCLUSION

To return to today's themes, significant potential exists to harness the underlying technology in fintech, digital assets, and cloud services adoption. However, there remain common risks, from inadequate oversight to excessive concentration to consumer harms. In each of these three areas, Treasury is actively engaged, including by coordinating with the official sector and other stakeholders to ensure we achieve outcomes that benefit all Americans and our economic values of fairness, growth, and competitiveness.

In addition to ensuring that policy is technology-neutral, we must also remember that technology itself is neutral in many respects. Ultimately, human beings are responsible for designing the information that goes in, the ways that information is processed, and how the resulting output is used. As Secretary Yellen has said, "just as much as we need responsible innovation, we also need equitable innovation."[15]

While we are monitoring emerging issues, the Administration is focused on maintaining the foundation of a stable and equitable financial system. In addition to addressing the risks presented by crypto-assets, we must remember that there are also issues in traditional finance that cause many Americans to distrust existing institutions and increase the appeal of misleading claims made by predatory actors. That is why the CFPB is taking steps to limit consumer credit card fees, potentially protecting Americans from billions of dollars per year in unfair costs.[16] The banking agencies are working towards issuing a proposal to implement enhancements to the Basel international capital rules, in order to ensure that our banking system remains resilient in the face of potential shocks.[17] And Treasury is making historic investments in CDFIs and minority depository institutions to support economic development in underserved communities and communities of color.[18] While some are pushing back on these efforts, and proposing deregulation as the alternative path, we have seen time and time again that strong regulation and consumer protection are vital to ensure that our financial system is a source of stability and equitable growth.

Thank you again for having me. I look forward to further engaging with you all on these and other topics.

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[1] *See* U.S. Department of the Treasury, *Assessing the Impact of New Entrant Non-Bank Firms on Competition in Consumer Finance Markets* (Nov. 2022), https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

[2] *See* President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

[3] *See* Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System, *Shadow Banking After the Financial Crisis* (Jun. 12, 2012), https://www.federalreserve.gov/newsevents/speech/tarullo20120612a.htm.

[4] *See* Caitlin Ostroff & Alexander Osipovich, *Cryptocurrency TerraUSD Falls Below Fixed Value, Triggering Selloff*, Wall Street Journal (May 9, 2022), https://www.wsj.com/articles/cryptocurrency-terrausd-falls-below-fixed-value-triggering-selloff-11652122461.

[5] *See* Financial Stability Oversight Council, *Proposed Recommendations Regarding Money Market Mutual Fund Reform*, 77 Fed. Reg. 69455 (Nov. 19, 2012), https://www.govinfo.gov/content/pkg/FR-2012-11-19/pdf/2012-28041.pdf.

[6] *See* Executive Order on Ensuring Responsible Development of Digital Assets, Exec. Order No. 14067, 87 Fed. Reg. 14143 (Mar. 9, 2022), https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/.

[7] *See* Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation* (Oct. 2022), https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf.

[8] *See* U.S. Department of the Treasury, *The Future of Money and Payments* (Sept. 2022), https://home.treasury.gov/system/files/136/Future-of-Money-and-Payments.pdf.

[9] *See* U.S. Department of the Treasury, *Crypto-Assets: Implications for Consumers, Investors, and Businesses* (Sept. 2022), https://home.treasury.gov/system/files/136/CryptoAsset_EO5.pdf.

[10] *See* Terri Bradford, *The Cryptic Nature of Black Consumer Cryptocurrency Ownership*, Federal Reserve Bank of Kansas City (Jun. 1, 2022), https://www.kansascityfed.org/research/payments-system-research-briefings/the-cryptic-nature-of-black-consumer-cryptocurrency-ownership/.

[11] *See* Peter Rudegeair, Alexander Osipovich & David Benoit, *How a Tiny Bank in a Washington Farming Town Got Tangled Up With FTX*, Wall Street Journal (Jan. 31, 2023), https://www.wsj.com/articles/how-a-tiny-bank-in-a-washington-farming-town-got-tangled-up-with-ftx-11675178539.

[12] *See* Federal Deposit Insurance Corporation, *Public Report of Entities Submitting Notices for a Primary Purpose Exception (PPE) as of 6/24/2022* (Jun. 24, 2022), https://www.fdic.gov/resources/bankers/brokered-deposits/public-report-ppes-notices.pdf; also Claire Williams, *The Unlikely Crypto Companies Using the Trump-Era 'Hot Money' Rule*, American Banker, (Feb. 6, 2023), https://www.americanbanker.com/news/the-unlikely-crypto-companies-using-the-trump-era-hot-money-rule.

[13] *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation & Office of the Comptroller of the Currency, *Joint Statement on Crypto-Asset Risks to Banking Organizations* (Jan. 3, 2023), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf.

[14] *See* U.S. Department of the Treasury, *The Financial Services Sector's Adoption of Cloud Services* (Feb. 2023), https://home.treasury.gov/system/files/136/Treasury-Cloud-Report.pdf.

[15] *See* U.S. Department of the Treasury, *U.S. Treasury Department Holds Financial Sector Innovation Policy* Roundtable (Feb. 10, 2021), https://home.treasury.gov/news/press-releases/jy0023.

[16] *See* Consumer Financial Protection Bureau, CFPB Proposes Rule to Rein in Excessive Credit Card Late Fees (Feb. 1, 2023), https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-rule-to-rein-in-excessive-credit-card-late-fees/.

[17] *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation & Office of the Comptroller of the Currency, Agencies Reaffirm Commitment to Basel III Standards (Sept. 9, 2022), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20220909a.htm.

[18] *See* U.S. Department of the Treasury, *community finance policy* (Dec. 1, 2022), https://home.treasury.gov/news/featured-stories/community-finance-policy.