

State, Regional, and Global Financial Regulation

Fireside Chat at the Wharton Future of Finance Forum

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Moderator:

- Burcu Esmer, Academic Co-Director of the Harris Family Alternative Investments Program and Senior Lecturer in Finance at the Wharton School of the University of Pennsylvania

Speaker:

- Adrienne Harris, Superintendent of the New York Department of Financial Services (NYDFS)

Dual Role in Financial Regulation: Local and Global

- The New York State Department of Financial Services (DFS) has a unique role as both a local and global financial regulator. This dual role is exemplified by its presence at events like state fairs, highlighting its grassroots engagement, and its authority over 17 Global Systemically Important Banks (G-SIBs), demonstrating its international reach. Such hyperlocal yet global regulation is a rarity, positioning DFS as a significant player in overseeing diverse entities, including pivotal financial institutions like Signature Bank.

Case Study: Signature Bank's Liquidity Crisis

- Signature Bank, despite its diversified clientele from cryptocurrency companies to small-scale vendors, encountered severe liquidity management challenges, notably due to its association with Silicon Valley Bank (SVB) events. This association triggered a crisis where 20% of deposits were withdrawn in a short period, indicating an extraordinary capital flight. Interestingly, the proportion of fleeing deposits mirrored the bank's crypto-related deposits, underscoring the crisis's complexity and the non-crypto origin.

Critical Lessons and Forward-Looking Regulation

- Traditional regulation hasn't sufficiently developed to address modern realities. The regulatory environment must adapt to a world where massive capital transfers can occur with a few phone taps, even in transit. This necessitates a paradigm shift towards regulations that aren't just robust in theory but agile in practice, equipped with rapid response and escalation protocols. It also underscores the importance of operational stress testing as a standard practice, ensuring institutions can autonomously implement crisis aversion strategies.

Cryptocurrency: Proving Its Market Utility

- The cryptocurrency sector stands on the cusp of its "Amazon moment" — poised for a transformative breakout, albeit still needing to demonstrate its mass-market applicability. In regulating this nascent industry, DFS updated its coin listing policy, reflecting a stringent approach to ensuring that crypto entities are as accountable as traditional banks, particularly regarding

capital requirements and anti-money laundering measures. This groundbreaking approach, evidenced by actions like being the first regulator to address issues with Binance, has set a regulatory precedent, influencing new legislation beyond New York and even the United States, as seen by similar frameworks emerging in the UAE and other regions.

Emphasizing Diversity in the Banking Sector

- A diverse banking ecosystem is paramount in serving varied demographics, highlighting satisfaction with commercial and community banks' current roles, especially in real estate. However, there's skepticism around bank mergers, questioning their implications for sector safety, soundness, and competition. Concerns arise that they may reinforce 'too big to fail' scenarios due to decreased competition, leading to unfavorable economic and policy outcomes.

Deposit Insurance and the Challenge with Uninsured Deposits:

- There is a need to revisit deposit insurance and coverage extents since the notion of zero uninsured deposits is impractical, especially in distinguishing consumer accounts from commercial ones. The traditional approach, especially the concept of zero uninsured deposits, is outdated in today's complex financial ecosystem.
- There should be an imperative review and overhaul of how deposit insurance is conceptualized, acknowledging the operational impracticalities between consumer and commercial account treatments. This aspect calls for a more nuanced, possibly tiered approach to insurance, reflecting the varied nature and risk profiles of modern deposit types.

Big Tech's Foray into Financial Services:

- The advent of big technology companies in financial services brings attention to community banks' necessity to adapt by embracing new technologies for survival. The integration of advanced tech solutions is key for these traditional institutions to remain competitive and relevant in the rapidly transforming financial landscape.

Anticipations for 2023 and Beyond

- Looking forward, we can anticipate more groundbreaking developments in cryptocurrency and digital assets. There's also an expectation for definitive guidance concerning AI in insurance and a close watch on the private equity sphere's growing interest in the life insurance market, identifying it as an emerging risk. These forward-looking insights suggest a trajectory towards more integrated, technology-aware financial regulation and supervision.