Monday, February 3, 2020

Top 10 risk and compliance related news stories and world events that (for better or for worse) shaped the week's agenda, and what is next

Dear members and friends,

We can read in *Juvenal's Satires:* "rara avis in terris nigroque simillima cygno" (a bird as rare on the earth as a black swan).

The term *black swan* was used in the 16th century in London, to describe something impossible or at least improbable.

I met Nassim Nicholas Taleb before a couple of years, during the RiskMinds International Conference, at Hotel Okura in Amsterdam. I attended his class after the conference, and we had the opportunity to discuss about his *black swan theory*.

The theory describes a high impact but low likelihood event, for which we are totally unprepared, as we consider it a black swan (we assume that it does not exist as a risk).

Today I read a paper with title *"The green swan. Central banking and financial stability in the age of climate change"* from the Bank of France (Patrick BOLTON, Morgan DESPRES, Luiz Awazu PEREIRA DA SILVA, Frédéric SAMAMA, Romain SVARTZMAN).

According to the paper, the "green swan" concept finds its inspiration in the famous concept of the "black swan" developed by Nassim Nicholas Taleb. Black swan events have three characteristics:
(i) they are unexpected and rare, thereby lying outside the realm of regular expectations;
(ii) their impacts are wide-ranging or extreme;
(iii) they can only be explained after the fact.

According to the paper (*The green swan*), black swan events can take many shapes, from a terrorist attack to a disruptive technology or a natural catastrophe. These events typically fit fat tailed probability distributions, ie they exhibit a large skewness relative to that of normal distribution (but also relative to exponential distribution).

As such, they cannot be predicted by relying on backward-looking probabilistic approaches assuming normal distributions (eg value-at-risk models). The existence of black swans calls for alternative epistemologies of risk, grounded in the acknowledgment of uncertainty.

For instance, relying on mathematician Benoît Mandelbrot (1924–2010), Taleb considers that fractals (mathematically precise patterns that can be found in complex systems, where small variations in exponent can cause large deviation) can provide more relevant statistical attributes of financial markets than both traditional rational expectations models and the standard framework of Gaussian-centred distributions (Taleb (2010)).

Read more at number 1 below. Welcome to the Top 10 list.

Best regards,

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Number 1 (Page 6)

The green swan

Central banking and financial stability in the age of climate change (115 pages). Patrick BOLTON - Morgan DESPRES - Luiz Awazu PEREIRA DA SILVA Frédéric SAMAMA - Romain SVARTZMAN, January 2020

Number 2 (Page 8)

EBA consults on the future of the EU-wide stress test framework

Number 3 (Page 11)

Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision

Vice Chair for Supervision Randal K. Quarles, at the American Bar Association Banking Law Committee Meeting 2020, Washington, D.C.

Number 4 (Page 24)

Intentional Use of Audio-Visual Distortions & Deep Fakes

Theodore E. Deutch, Florida
Chairman
Kenny Marchant, Texas
Ranking Member

Grace Meng, New York
Susan Wild, Pennsylvania
Dean Phillips, Minnesota
Anthony Brown, Maryland

John Ratcliffe, Texas
George Holding, North Carolina
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Number 5 (Page 26)

Basel III: the implementation imperative

Keynote address by Pablo Hernández de Cos, Chair of the Basel Committee on Banking Supervision and Governor of the Bank of Spain, at the 15th BCBS-FSI High-level Meeting for Africa on Strengthening financial sector supervision and current regulatory priorities, Cape Town.

Number 6 (Page 28)

Policy responses to fintech: a cross-country overview

Johannes Ehrentraud, Denise Garcia Ocampo, Lorena Garzoni, Mateo Piccolo, January 2020

Number 7 (Page 30)

How can a united Europe meet the challenges it faces today?

Christine Lagarde, President of the European Central Bank, during a dinner on "Uniting Europe", World Economic Forum, Davos.

Number 8 (Page 33)

Protecting Wideband RF Systems in Congested Electromagnetic Environments

New program aims to develop wideband adaptive RF circuit technology to mitigate interference from external and self-generated signals

Number 9 (Page 36)

Microsoft Releases Security Advisory on Internet Explorer Vulnerability

Cybersecurity and Infrastructure Security Agency (CISA)

Number 10 (Page 37)

Mitigating Cloud Vulnerabilities

Number 1

The green swan

Central banking and financial stability in the age of climate change (115 pages). Patrick BOLTON - Morgan DESPRES - Luiz Awazu PEREIRA DA SILVA Frédéric SAMAMA - Romain SVARTZMAN, January 2020

Climate change poses new challenges to central banks, regulators and supervisors. This book reviews ways of addressing these new risks within central banks' financial stability mandate.

However, integrating climate-related risk analysis into financial stability monitoring is particularly challenging because of the radical uncertainty associated with a physical, social and economic phenomenon that is constantly changing and involves complex dynamics and chain reactions.

Traditional backward-looking risk assessments and existing climate - economic models cannot anticipate accurately enough the form that climate-related risks will take.

These include what we call "green swan" risks: potentially extremely financially disruptive events that could be behind the next systemic financial crisis.

Central banks have a role to play in avoiding such an outcome, including by seeking to improve their understanding of climate-related risks through the development of forward-looking scenario-based analysis.

But central banks alone cannot mitigate climate change. This complex collective action problem requires coordinating actions among many players including governments, the private sector, civil society and the international community.

Central banks can therefore have an additional role to play in helping coordinate the measures to fight climate change. Those include climate mitigation policies such as carbon pricing, the integration of sustainability into financial practices and accounting frameworks, the search for

appropriate policy mixes, and the development of new financial mechanisms at the international level.

All these actions will be complex to coordinate and could have significant redistributive consequences that should be adequately handled, yet they are essential to preserve long-term financial (and price) stability in the age of climate change.

To read more you may visit: https://www.bis.org/publ/othp31.pdf

Number 2

EBA consults on the future of the EU-wide stress test framework

The European Banking Authority (EBA) launched today a public consultation on possible future changes to the EU-wide stress test.

This discussion paper aims to present the EBA's vision of the future of the EU-wide stress test and to collect comments and feedback from the different users.

The proposal envisages two components owned by supervisors and banks respectively: the supervisory leg and the bank leg.

The consultation runs until 30 April 2020.

> *"The framework we are proposing today aims at making the EU-wide stress test more informative, flexible, and cost-effective. It is the first time we embark on a comprehensive discussion on the future of EU stress testing and we are keen to receive feedback from a wide range of stakeholders."*
>
> **José Manuel Campa, EBA Chairperson**

Key features of the new framework

Since 2011, the EU-wide stress test has contributed to improving banks' resilience after the financial crisis, has enhanced transparency and has been instrumental in restoring trust in the EU banking sector.

The proposed new framework tries to balance the need to preserve comparability and conservatism, while allowing for more flexibility in order to identify banks' idiosyncratic risks.

The proposal envisages two components owned by supervisors and banks respectively: the supervisory leg and the bank leg.

The supervisory leg serves as the starting point for supervisory decisions and would be directly linked to the setting of Pillar 2 Guidance (P2G).

The bank leg, on the other hand, allows banks to communicate their own assessment of risks in an adverse scenario.

To ensure a certain level of comparability, both legs would use the same common scenarios and starting points for projecting the stress test results.

The supervisory leg would be based on a common EU methodology, in line with the current constrained bottom-up approach but with the possibility for competent authorities to adjust or replace banks' estimates based on top-down models or other benchmarking tools.

The methodology for the bank leg would be less prescriptive than today and give banks more discretion in calculating their projections.

In practice, banks would use the same common methodology as in the supervisory leg, but would be allowed to relax the methodological constraints to the extent they can explain and disclose the rationale and impact of such deviations.

The standards for the disclosure of the results should remain high.

For the bank leg, the proposed disclosure is as granular as it is today, including the overall outcome in terms of capital depletion, main risk drivers, and detailed data on exposures.

For the supervisory leg, granularity would be more limited in quantity, but very relevant in terms of supervisory decisions.

In particular, the discussion paper seeks views on three possibilities:

(i) disclosing P2G,

(ii) disclosing ranges of P2G or

(iii) disclosing not P2G but the CET1 capital depletion net of any supervisory adjustments so that the results are informative in terms of supervisory expectations regarding capital distribution.

As for the scenario design, the discussion paper is considering costs and benefits of multiple macroeconomic scenarios.

In addition, feedback is requested on the feasibility of introducing exploratory scenarios, which would focus on potential risks with very short realisations (e.g. liquidity risk) or coming from longer-term changes in the business environment (environmental, social and political) or in technology.

Consultation process

Comments to this consultation can be sent to the EBA by clicking on the "send your comments" button on the consultation page. Please note that the deadline for the submission of comments is 30 April 2020.

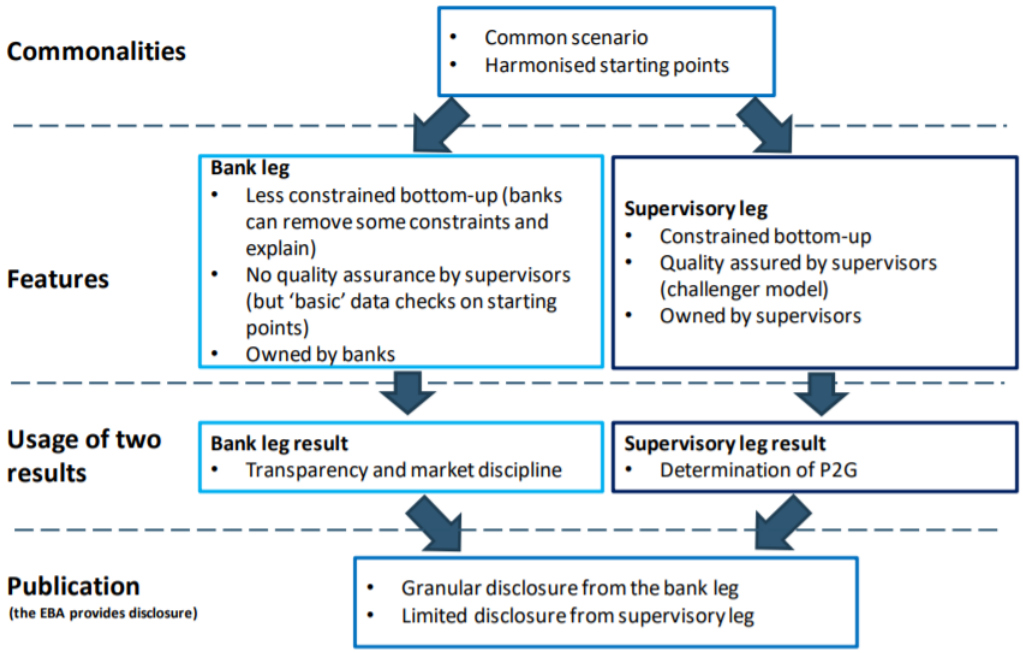
A public hearing will take place at the EBA premises on 21 February 2020 from 10:30 to 12:30 CET. All contributions received will be published following the end of the consultation, unless requested otherwise.

Note

The 2020 EU-wide stress test will be conducted according to the current framework and its results will be published in July 2020.

To read more:
https://eba.europa.eu/calendar/discussion-paper-future-changes-eu-wide-stress-test

Figure 1: Proposed framework for a EU-wide stress test with a two-legged approach



Number 3

Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision

Vice Chair for Supervision Randal K. Quarles, at the American Bar Association Banking Law Committee Meeting 2020, Washington, D.C.

It's a great pleasure to be with you today at the ABA Banking Law Committee's annual meeting.

I left the practice of law—and immersion in the company of lawyers—closing in on 20 years ago now, but there have been many times during my long sojourn among businessmen and economists that I have reflected with fondness and some nostalgia on the famous adage of Harrison Tweed (the "Tweed" of Milbank, Tweed, a reformer of the bar, the "most democratic of aristocrats," and the last man to unironically wear a cape in the lobby of the Chase Manhattan Plaza) which most of you can no doubt recite by heart: "I have a high opinion of lawyers.

With all their faults, they stack up well against those in every other occupation or profession. They are better to work with or play with or fight with or drink with than most other varieties of mankind." Speaking here feels a lot like coming home.

This afternoon, I would like to talk with you about the outwardly mundane but increasingly consequential topic of bank supervision.

Twenty years ago, when I would have been among your number at this meeting, this would have been my cue to pull out my Blackberry and start checking my emails.

The structure and content of regulation was both intellectually interesting and professionally meaningful; I considered bank supervision, by contrast, as both too workaday and too straightforward to merit the commitment of much legal horsepower or personal attention.

I could perhaps have been excused by the callowness of youth, yet it was a common view at the time.

Having now been immersed for the last two years both in the practice of supervision and in the complementary relationship between the regulatory and supervisory processes, I realize that this wasn't true then, and is certainly not true now.

It is not a drafting accident that the Dodd-Frank Act gave my position at the Federal Reserve the title of Vice Chairman for Supervision.

Notwithstanding the extensive reform of bank regulation after the crisis, which has had much consequence for the industry (most of it salutary) it is the process of examination and supervision that constitutes the bulk of our ongoing engagement with the industry and through which our policy objectives are given effect.

This division of labor is important for lawyers and policymakers to think about deeply because the processes of regulation and supervision are necessarily different in crucial respects.

Regulation establishes a binding public framework implementing relevant statutory imperatives. Because a rule is designed to apply generally, rules must be based on general principles intended to achieve general aims, rather than reverse-engineered to generate specific effects for specific institutions.

Given their general applicability, there must be a general process for all those with an interest—industry, academics, citizens, Congress—to have notice of, and opportunity to comment on all rules, ensuring that all potential effects and points of view are taken into account in the rule's crafting. And given their general function, rules must be clear and public: Those affected must know what to expect and what is expected.

Supervision, by contrast, implements the regulatory framework through close engagement with the particular facts about particular firms: their individual capital and liquidity positions, the diverse composition of their distinct portfolios of assets, their business strategies, the nature of their operations, the strengths and weaknesses of their management.

Much of the granular information used by supervisors is, accordingly, proprietary and confidential, and many of their judgments and decisions are closely tailored to specific circumstances.

Given the strong public interest in the safe, sound, and efficient operation of the financial industry and the potential for hair-raising and widespread adverse social consequences of private misjudgment or misconduct in that industry, close and regular supervision of this sort can help us all sleep

restfully. Yet, the confidential and tailored nature of supervision sits uncomfortably with the responsibilities of government in a democracy. In the United States, we have a long-standing, well-articulated framework for ensuring that regulations conform with the principles of generality, predictability, publicity, and consultation described above.

Supervision—for good reason, in my view—is not subject to this formal framework. But it is currently not subject to any specific process constraint promoting publicity or universality. This leaves it open to the charge, and sometimes to the fact, of capriciousness, unaccountability, unequal application, and excessive burden.

Here, then, is a conundrum. We have a public interest in a confidential, tailored, rapid-acting and closely informed system of bank supervision. And we have a public interest in all governmental processes being fair, predictable, efficient, and accountable.

How do we square this circle? In my time with you today, we will not do more than scratch the surface of this question. It is a complex and consequential issue that, for decades now, has received far too little attention from practitioners, academics, policymakers and the public.

Evaluating this question will be a significant focus of mine going forward, and I hope that there will be much discussion in many fora from which we at the Fed, and at other regulators, can learn. So today, I simply want to open the exploration of some these conceptual issues, and then offer some specific suggestions—by no means comprehensive—on some obvious and immediate ways that supervision can become more transparent, efficient, and effective.

The Importance of Transparency

Let me begin by delving a little more deeply into the distinction between regulation and supervision and the process applicable to both. In delegating to agencies such as the Fed the significant power to write regulations, Congress has codified a regulatory process that emphasizes transparency.

This process was born in the 1930s, in the tumult of government expansion that was the New Deal, when Congress began a decade-long debate over how to manage the new regulatory state.

The result, the Administrative Procedure Act (APA), was, I should note, developed with the active involvement of the American Bar Association. The APA continues to serve as the basis for the public disclosure and

participation required for agency rule-writing and for the judicial review affected parties are guaranteed to challenge rules.

This transparency is intended to prevent arbitrary, capricious, and thus ineffective regulation by inviting broad public participation and mandating a deliberate public debate over the content of proposed rules. One obvious purpose of this transparency is to provide clarity and predictability: it helps make clear how agencies are considering exercising their discretion.

The significant process protections in laws such as the APA are also meant to ensure fairness. The wisdom behind this approach is that fairness both helps bring forth more considered and effective regulations and builds respect for and adherence to the law, which is essential for enforcement. Transparency is central to our ability to assert that our rules are fair.

Not everything that government does, however, can be accomplished in exactly the same way that regulations are written. One of these things is bank supervision.

Bank Supervision

Banks are subjected to supervision, in addition to regulation, as an additional form of government oversight because of their complexity, opacity, vulnerability to runs, and indispensable role in the economy, enabling payments, transmitting monetary policy, and providing credit.

The government provides a safety net to banks in the form of deposit insurance, and in return, banks are subject to government oversight that mimics some of the monitoring that the private sector would provide, absent the government safety net.

The bank regulatory framework sets the core architectural requirements for the banking system, but it isn't enough to set the rules and walk away like Voltaire's god.

The potential consequences of disruption in the financial system are so far-reaching, and the erosion of market discipline resulting from the government safety net sufficiently material, that it is neither safe nor reasonable to rely entirely on after-the-fact enforcement to ensure regulatory compliance.

Supervisors are in a good position to monitor individual firms' idiosyncratic risks. And in addition to what they do at individual banks, supervisors monitor for risk that may be building among clusters of banks or across the banking system.

These "horizontal" exams across multiple banks help highlight new or emerging risks and help examiners understand how banks are managing these risks.

Through their engagement with banks, supervisors promote good risk management and thus help banks preemptively avert excessive risk taking that would be costly and inefficient to correct after the fact.

Where banks fall materially out of compliance with a regulatory framework or act in a manner that poses a threat to their safety and soundness, supervisors can act rapidly to address the failures that led to the lack of compliance or threat to safety and soundness.

This is a crucial point: Supervision is most effective when expectations are clear and supervision promotes an approach to risk management that deters bad behavior and decisions by banks.

Clearly communicating those expectations is essential to effective supervision, and in a larger sense, clear two-way communication is the essence of effective supervision.

Supervisors rely on banks to be frank and forthcoming, and supervisors in turn can help secure that frankness by explaining what their expectations are and why their expectations are reasonable, not arbitrary or capricious.

Greater transparency in supervision about the content of our expectations and about how we form our expectations and judgments can make supervision more effective by building trust and respect for the fairness and rationality of supervision.

I don't believe the Federal Reserve has communicated as clearly as it could with the banks we supervise. More transparency and more clarity about what we want to achieve as supervisors and how we approach our work will improve supervision, and I have several specific proposals.

Broadly speaking, these actions fall into three categories:

(1) large bank supervision,
(2) transparency improvements, and
(3) overall supervisory process improvements.

Large Bank Supervision

Last fall, we completed a cornerstone of the recent banking legislation to tailor our rules for regional banks. This was entirely consistent with a

principle at the heart of our existing work: Firms that pose greater risks should meet higher standards and receive more scrutiny. Our previous rules relied heavily on a firm's total assets as a proxy for these risks and for the costs the financial system would incur if a firm failed.

This simple asset proxy was clear and critical, rough and ready, but neither risk sensitive nor complete. Our new rules employ a broader set of indicators, like short-term wholesale funding and off-balance-sheet exposures, to assess the need for greater supervisory scrutiny.

That said, the composition of our supervisory portfolios has not yet been aligned with our recent tailoring rules. For example, the Large Institution Supervision Coordinating Committee (LISCC) portfolio includes all Category I firms, which have the greatest risk profile, along with certain Category II and Category III firms, which are less systemic.

Other Category II and Category III firms, on the other hand, are supervised under our large and foreign banking organizations (LFBO) portfolio.

Since the crisis, we have been giving significant thought to the composition of our supervisory portfolios, and, in particular to whether and how we should address the significant decrease in size and risk profile of the foreign firms in the LISCC portfolio over the past decade.

Because of these changes, which I will describe in more detail momentarily, I believe there is a compelling justification to make changes today to the composition of the foreign banks in the LISCC portfolio.

Separately and in keeping with the goal of transparency, I think it is important that all the Fed's supervisory portfolios have a clear and transparent definition.

Today nearly all of our supervisory portfolios have such a crisp and clear formulaic definition specified in the public domain, but the LISCC portfolio does not.

My goal is to develop, prospectively, a clear and transparent standard for identifying LISCC firms. My preferred approach for achieving this objective would be to align the LISCC portfolio with our recent tailoring categorizations.

I believe we should draw the LISCC line to coincide with Category I. The justification for this line-drawing is that Category I firms pose the most systemic risk and require the most supervisory attention.

In this state of the world, Category II and III firms would remain subject to heightened supervisory standards that are commensurate with their risk profile.

Allow me to draw out what this approach could mean for the foreign banks that currently are in the LISCC portfolio.

Since 2010, these four banks have significantly shrunk their U.S. footprint, and their U.S. operations are much less risky than they used to be.

Since 2008, the size of the LISCC FBOs' combined U.S. assets has shrunk by about 50 percent, and they have reduced the assets at their broker-dealers from a peak of $1.9 trillion in 2008 to $340 billion today, a reduction of over 80%.

In addition, the estimated systemic impact of the LISCC FBOs today is much smaller than the U.S. GSIBs. The average method 1 GSIB score of the combined U.S. operations of the LISCC FBOs is less than a quarter of the average GSIB score of the six non-processing U.S. GSIBs.

Thus, if any foreign banks move out of the LISCC portfolio based on this de-risking, they would move into the LFBO portfolio, where they would be supervised alongside other foreign and domestic firms with similar risk profiles.

Notably, this change in supervisory portfolio would have no effect on the regulatory capital or liquidity requirements that currently apply to the four LISCC FBOs. Similarly, the change would not result in a loss of insight into the activities of these firms.

In the same spirit, I think we should consider publishing the internal procedural materials that the Fed uses to supervise the LISCC firms, sometimes referred to as the Program Manual.

The Manual contains a description of the main supervisory processes for identifying risks and our approach for addressing them. Publishing the Manual would help the public and the banks better understand why we take the actions that we take as supervisors and would demystify some of our processes.

If we took these two simple steps—defining LISCC firms and publishing the Program Manual that governs our supervisory approach—it would go a long way in helping to make our supervisory practices more understandable and accessible without undermining supervisory effectiveness.

Let me now turn to the ratings framework that applies to all large holding companies. A firm's supervisory rating, which is confidential, is important because it affects things such as the firm's ability to engage in mergers and acquisitions and to enter new lines of business.

Just over a year ago, the Board began implementing a new ratings framework for large holding companies called the large financial institutions (LFI) ratings framework.

The LFI ratings framework focuses on three components of a firm's operations: capital, liquidity, and governance and controls. We inaugurated the LFI ratings framework for LISCC firms in January 2019 and for other large holding companies at the beginning of this year.

As we gain more experience with LFI, we will be paying close attention to how the new rating system is working and whether it is achieving its intended purpose. There are two features of the ratings system that I will be particularly interested to monitor, and which may well require adjustment.

These are the embedding of qualitative "risk management" standards in the capital and liquidity components of the ratings (as opposed to standardized quantitative measures of capital and liquidity adequacy) and the ascetic principle by which a firm's "well managed" status is determined by its lowest component rating, no matter how good the bank is at everything else.

Regarding our stress tests under the Comprehensive Capital Analysis and Review (CCAR), I continue to look for ways to make the tests more transparent without making them game-able and without diluting their potency as a supervisory tool. I will mention three of these transparency-enhancing ideas.

First, I expect that we will continue to provide more transparency on the models used in CCAR. We started providing improved transparency on models last year, and as I have previously said, we will remain on that path until we have released substantial details on all of our key models.

We also continue to consider ways to increase the transparency around the scenarios we use in CCAR, including, for example, by modifying our scenario design policy statement to provide greater transparency on the design of the global market shock component of the stress tests.

Second, I expect that as part of the stress capital buffer, we will give banks significantly more time to review their stress test results and understand their capital requirements before we demand their final capital plan.

Firms are currently permitted to revise and resubmit their capital plans after receiving their stress test results. But it is done on a short timeframe, and allowing additional time would produce better results without in any way reducing the stringency of the stress tests.

Fundamentally, I think banks will be better able to do intelligent capital planning if we provide them with their complete set of regulatory capital requirements before we require submission of a capital plan.

Third and finally, we continue to look for ways to reduce the volatility of stress-test requirements from year to year. We are considering a number of options, such as averaging outcomes over multiple years or averaging the results of the current year's stress test with the results of one or more previous years.

Again, the goal here is not to make the tests less strenuous but to give banks a greater opportunity to plan for them and to meet our expectations ex ante rather than through an ex post remedial process.

Transparency Improvements

The next three actions I'm proposing also relate to improved transparency, and they would improve our processes for supervising all banks. The first would be to create a word-searchable database on the Board's website with the historical interpretations by the Board and its staff of all significant rules.

Regulatory interpretations by Board staff have grown piecemeal over the decades and haven't consistently been treated as the valuable resource they are. The Board's website has select interpretations of many laws but does not provide a comprehensive, user-friendly collection of regulatory interpretations, FAQs, and commentary.

This project will require some effort of course, as well as vigilance to keep the interpretations up to date, but I believe that the end result will be well worth it.

The second of these transparency actions would be putting significant supervisory guidance out for public comment. The Board already invites comments on its regulations, as required under the APA, and regularly invites comment on some supervisory guidance and statements of policy.

This practice of seeking comment on guidance leads to better, more informed supervision and better engagement by banks. I would like the Board to seek comment on more supervisory guidance going forward.

Third and finally, as another improvement related to guidance, I support submitting significant supervisory guidance to Congress for purposes of the Congressional Review Act.

Currently, the Fed does this for rules but not guidance. I support doing so for significant guidance because significant guidance, though nonbinding, can still have a material impact on bank behavior. I believe this step would enhance the Fed's accountability and help build support for supervisory guidance.

Overall Supervisory Process Improvements

The last category of proposals includes five areas of improvement that all relate to what we call the "supervisory process"—how we go about conducting our responsibilities. Like my other suggestions, these are all rooted in common sense with a view toward maintaining firm and fair supervision.

The first is to increase the ability of supervised firms to share Federal Reserve confidential supervisory information (CSI) with employees, affiliates, service providers, and other government agencies to promote greater compliance with laws and facilitate the response to enforcement actions.

We have received feedback that our rules can prevent banks from sharing CSI with a wide variety of relevant parties who need to know this information in order to help the bank remediate identified supervisory issues. We issued a proposal last year to address this shortcoming in our CSI rules, and I expect the Board will be able to issue a final CSI rule later this year.

The second process improvement is having the Board adopt a rule on how we use guidance in the supervisory process. I would expect the rule to state that the Board will follow and respect the limits of administrative law in carrying out its supervisory responsibilities.

In particular, consistent with the September 2018 interagency statement on guidance, we would affirm the sensible principles that guidance is not binding and "non-compliance" with guidance may not form the basis for an enforcement action (such as a cease-and-desist order) or supervisory criticism (such as a Matter Requiring Attention (MRA)).

This rule would be binding on the Board and on all staff of the Federal Reserve System, including bank examiners.

The third and fourth process improvements relate to supervisory communication. The third improvement is to restore the "supervisory observation" category for lesser safety and soundness issues.

This approach would provide supervisors with a tool—supervisory recommendations—for continuing to raise concerns about less pressing supervisory matters while focusing a bank's attention on the most urgent matters, those that would receive MRAs.

We removed this category of supervisory commentary in 2013 to better focus bank management on deficiencies found during the supervision process. (By way of comparison, both the FDIC and OCC retained this tool.) On reflection, I think there is value in supervisory observations. They allow an examiner to give notice about a supervisory concern even if that concern has not risen to the level of an MRA.

The fourth process improvement would be limiting future MRAs to violations of law, violations of regulation, and material safety and soundness issues. MRAs are supervisory communications that identify areas where banks are out of compliance with applicable legal standards or otherwise are engaged in practices that create substantial safety and soundness risks.

MRAs identify the source of the compliance failure, deficiency, or safety and soundness weakness and generally include an expected timeframe for remediation. MRAs are not legally binding and are not enforcement actions.

Nevertheless, MRAs carry weight because they can affect a bank's supervisory rating. In limiting MRAs to legal violations and significant supervisory concerns, we would take care to clearly define the breadth of what constitutes a "material safety and soundness issue." This distinction is important as a matter of fairness.

Banks should be able to understand the line between MRAs significant enough to affect the bank's supervisory rating and less significant matters that don't affect a bank's supervisory rating but raise concerns that should be considered by banks.

Greater fairness contributes to greater supervisory effectiveness. Together, the third and fourth process improvements would be calibrated to improve communications so that banks can focus on remediating key weaknesses while maintaining awareness of emerging ones. Ultimately, a bank that promptly corrects its material safety and soundness weaknesses will be

better able to serve its customers and intermediate credit through a range of scenarios, including under stress.

The final process improvement is to make routine our existing practice of having an independent review of important supervisory communications and guidance documents. We want to make sure that our supervisory communications, including MRAs, focus on violations of law and material safety and soundness issues and that these communications don't mistakenly give the impression that supervisory guidance is binding.

We already closely scrutinize MRAs issued to the LISCC firms and in horizontal reviews of other large domestic and foreign banks. This extra scrutiny is a sensible practice that should be regularized and expanded across our supervisory portfolios.

With respect to prospectively assessing future guidance, the key goals here would include reassessing the scope of key guidance documents, removing inappropriate bright lines from guidance, and removing any mandatory language from guidance. I will discuss each of these goals in turn.

As I mentioned, the Board adopted a final tailoring rule last year that adjusted the regulatory standards applicable to banks, based on their risk profile. I think it would be useful for us to review our guidance in light of this tailoring exercise, such as guidance on stress testing and capital planning, and to update the scope of guidance where appropriate.

Regarding bright lines, bright lines tend to carry the implication that the standard they are delineating is binding. For this reason, rules often include bright lines so that it is clear how to stay in compliance with the rule. Putting bright lines in guidance, even when the bright line is phrased as a "should" rather than as a requirement, blurs the line between guidance and rules, and for this reason, it is a practice we should avoid.

For the same reason, it is inappropriate to put mandatory language in guidance. This practice can create the same distortions as the use of bright lines.

Conclusion

Obviously, the incremental changes to our supervisory processes described above do not completely answer the question with which I began my remarks today: How can we square the public interest in agile supervision with the public interest in transparency and accountability? This should be an ongoing question of high priority, both at the Fed and more broadly among those who care about our system of financial regulation.

Equally obviously, however, these suggestions would strengthen our practice of supervision and increase the vigor and credibility of our supervisors.

The changes to supervision since the crisis have made the financial system stronger and more resilient than it was before. The incremental changes I have outlined, to increase transparency, accountability, and fairness, would make supervision more efficient and effective, and our financial system stronger and more stable.

Number 4

Intentional Use of Audio-Visual Distortions & Deep Fakes

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This memorandum serves as a reminder that Members must exercise care in communicating, especially when using electronic communication, such as email, websites, Facebook, Twitter, Instagram, or YouTube.

All House Members, officers, and employees must conduct themselves at all times in a manner that reflects creditably on the House.

As Members of the House of Representatives, we are widely recognizable public servants.

Communicating with our constituents and the public is one of our most important duties.

Electronic communication has drastically improved our ability to communicate directly and in real-time with our constituents at a minimal cost.

The fast pace and wide dissemination of electronic communication can lead to mistaken transmissions; for example, emailing the wrong person, posting a private message publicly, or sharing the wrong video.

All of these examples of mistakes may be embarrassing and have unintended consequences.

However, intentional distortions of audio and/or visual representations can be far more damaging.

Members have a duty, and a First Amendment right, to contribute to the public discourse, including through parody and satire.

However, manipulation of images and videos that are intended to mislead the public can harm that discourse and reflect discreditably on the House.

Moreover, Members or their staff posting deep fakes "could erode public trust, affect public discourse, or sway an election."

Accordingly, Members, officers, and employees posting deep fakes or other audio-visual distortions intended to mislead the public may be in violation of the Code of Official Conduct.

Prior to disseminating any image, video, or audio file by electronic means, including social media, Members and staff are expected to take reasonable efforts to consider whether such representations are deep fakes or are intentionally distorted to mislead the public.

The Committee has long held that Members are responsible for the actions of their staff.

Further, Members must take reasonable steps to ensure that any outside organization over which the Member exercises control—including a campaign entity—operates in compliance with applicable law.

Accordingly, Members should ensure their official and campaign staff are familiar with the rules and regulations regarding electronic communications that those staff are involved in preparing or disseminating.

If you have any questions regarding this guidance, please feel free to contact the Committee's Office of Advice and Education at (202) 225-7103.

Number 5

Basel III: the implementation imperative

Keynote address by Pablo Hernández de Cos, Chair of the Basel Committee on Banking Supervision and Governor of the Bank of Spain, at the 15th BCBS-FSI High-level Meeting for Africa on Strengthening financial sector supervision and current regulatory priorities, Cape Town.

Good morning, and welcome to the 15th BCBS-FSI High-level Meeting for Africa. Let me start by thanking Governor Kganyago and the South African Reserve Bank (SARB) for hosting this meeting in Cape Town.

As the global standard setter for banks, the Basel Committee places great importance on reaching out to a wide range of stakeholders to inform its work.

Events such as these high-level meetings are of particular value to the Committee in seeking the views of central banks and supervisory authorities across different regions of the world.

With a population of over 1.2 billion and a median age of 19 years, Africa will play an increasingly important role in shaping the future world economy.

The average annual GDP growth in Africa has exceeded the global average over the past several years, and six of the world's 10 fastest-growing economies hail from this continent.

My remarks today will focus primarily on the imperative of implementing the Basel Committee's post-crisis reforms.

I'm pleased to note that the SARB takes this imperative seriously: it has a strong track record of implementing the Basel III standards in a timely and consistent manner.

And Governor Kganyago's chairmanship of the Financial Stability Board's Standing Committee on Standards Implementation underscores the SARB's commitment to this imperative.

I will frame my remarks around four questions:

- Why does implementation matter?

- What has the Basel Committee done to meet the implementation imperative?

- What have we seen to date among our members?

- Where does this leave us?

To read more:
https://www.bis.org/speeches/sp200130.pdf

Number 6

Policy responses to fintech: a cross-country overview

Johannes Ehrentraud, Denise Garcia Ocampo, Lorena Garzoni, Mateo Piccolo, January 2020

Technological innovations in financial services (fintech) are increasingly transforming the way financial services are provided. This transformation opens opportunities but comes with potential risks to consumers and investors and, more broadly, to financial stability and integrity, which financial regulation seeks to mitigate.

As for opportunities, fintech can support potential growth and poverty reduction by strengthening financial development, inclusion and efficiency. In this context, financial authorities are adjusting their policy frameworks and providing guidance based on their assessments of the implications of emerging technologies for the financial sector.

The challenge for policymakers is to maximise the benefits of fintech while minimizing potential risks for the financial system. However, this is easier said than done as regulators face several challenges.

Fintech developments present issues that are beyond the traditional scope of financial authorities, and the speed of innovation makes it difficult for regulators to respond in a timely manner. Also, important trade-offs may arise between different policy objectives.

This paper surveys 31 jurisdictions on their policy responses to fintech developments. The key aim of our study is to provide a cross-country overview of the responses that financial authorities have pursued in relation to fintech.

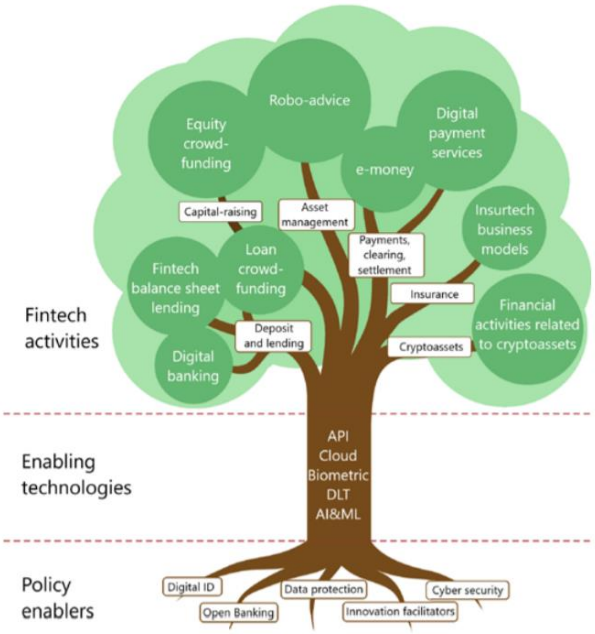
The paper is based on responses to a survey conducted in early 2019 by the Financial Stability Institute (FSI), which was supplemented by a comprehensive review of published regulations and documents as well as the authors' own analysis.

Building on the work by global standard-setting bodies and other international organisations, we propose a conceptual framework through which we analyse policy responses to fintech, referred to as the "fintech tree" (see chart on next page).

The fintech tree distinguishes three categories: fintech activities, enabling technologies and policy enablers. Fintech activities (eg digital banking or robo-advice) can take various forms and may be performed in different sectors of the financial industry.

Enabling technologies (eg cloud computing or artificial intelligence) are those that make innovation possible in the provision of financial services and, as such, form the backbone of fintech activities. Policy enablers refer to public policy measures and initiatives (eg digital ID systems) that support the development of fintech activities and the use of enabling technologies.

To read more:
https://www.bis.org/fsi/publ/insights23.pdf



Source: FSI staff.

Number 7

How can a united Europe meet the challenges it faces today?

Christine Lagarde, President of the European Central Bank, during a dinner on "Uniting Europe", World Economic Forum, Davos.

This year marks the 70th anniversary of the Schuman declaration, which first put forward the idea of a single authority to govern the production of coal and steel in Europe.

Robert Schuman's method for building Europe was clear: "Europe will not be made all at once", he said, but "through concrete achievements which first create a de facto solidarity".

His idea was that, by taking deliberate policy steps to become interdependent - like sharing raw materials - European countries would become inseparable.

And indeed they have. We have become both safer and richer. The formation of the Single Market gives every EU citizen average welfare gains of €840 each year[1].

Today, Schuman's sequence is, in some ways, being reversed.

Interdependence is now being driven increasingly by a fast-changing global environment - and policymaking has to catch up.

European countries have joint exposures to the climate, to the global economy, to multinational firms, to foreign powers. And now we need to work together to address them.

So what does that mean practically? There are three key aspects.

The first is demonstrating what is needed to make openness globally sustainable.

The EU is the most advanced example of cross-border economic and political integration because it has invested in institutions to ensure fairness - a single court and a single set of rules.

And when new forces have arisen with the potential to undermine openness - the threat of competitive devaluations or of financial spillovers - Europe has not responded by raising barriers.

Rather it has sought - and is seeking - to fill the gaps in its economic and monetary union with institutional innovations like the banking union.

At a time when trade tensions are rising even as global institutions are being weakened, these examples can provide useful lessons.

The second aspect is leveraging the areas where the EU is powerful, namely the Single Market.

The EU has become a leader in ensuring strict and fair competition laws which are enforced at arm's length[2]. This is crucial at a time when winner-takes-all dynamics are increasing in many markets, which raises concerns about firms' political and market power.

For example, in 2018 the average monthly cost of broadband was about 100% higher in the US than in Europe[3]. Lobbying expenditures in the US are also estimated to be twice as high.

So this is an area where Europe really gives power back to ordinary people.

Being the world's largest exporter of manufactured goods and services and the biggest export market for around 80 countries gives the EU considerable power as a global standard-setter, too[4].

In the past this capacity mainly affected technical areas that were less visible to the public, like chemicals and food standards. But today it clearly helps us to protect and share our values.

Take for example the EU's Data Protection Directive. Since it was passed, over 30 countries have adopted EU-type privacy laws, including most OECD countries.

Reflections are now also under way on how the EU's market force can be harnessed to accelerate the fight against climate change.

The third aspect is linking Europe's potential more visibly to people's concerns.

If we ask Europeans today what they see as the main issues for the EU, 38% say climate change or the environment, 34% say immigration and 30% say the economic situation or unemployment[5].

These are mostly challenges that have a cross-border, geopolitical or technological dimension.

The upshot is that the areas where Europe adds the most value - addressing challenges that are beyond the remit of nation states alone - are the areas where people now want to see results.

This provides a huge opportunity for the EU to connect more strongly with its citizens and to strengthen the foundations of the European project.

Doing so would in turn set the stage for integration in more complex areas, like fiscal policies.

Empirical evidence suggests that EU citizens tend to be much more supportive of economic integration if it rests on a sense of togetherness rather than focusing solely on maximising economic performance[6].

In the spirit of Schuman, a united Europe is one that acts with Europeans' common good at heart and addresses their challenges in a tangible way.

If we look to our past, we are reminded that economic integration can only be sustainable if it is based on a culture of stability, fairness and togetherness.

And if we look ahead, it is clear that a united Europe needs to provide the public goods that will shape our common future: turning challenges into opportunities in our natural, digital and economic environment.

And the ECB, within its mandate, will play its role in upholding this spirit and tackling the shared challenges we face.

Number 8

Protecting Wideband RF Systems in Congested Electromagnetic Environments

New program aims to develop wideband adaptive RF circuit technology to mitigate interference from external and self-generated signals

DEFENSE ADVANCED RESEARCH PROJECTS AGENCY

Today's electromagnetic (EM) spectrum is a scarce resource that is becoming increasingly congested and contested as friendly, unfriendly, and neutral entities vie for available spectrum resources at any given time, location, and frequency.

Within the Department of Defense (DoD), radio frequency (RF) systems, such as communications networks and radar, must operate within this congested environment and contend with mission-compromising interference from both self- and externally generated signals.

A desire to support wideband EM spectrum operations also adds to the burden, as current approaches to mitigating wideband receiver interference are sub-optimal and force compromises around signal sensitivity, bandwidth usage, and system performance.

Further, in the case of self-interference, traditional mitigation approaches such as antenna isolation alone are often not sufficient for protecting wideband receivers.

"Protecting our wideband digital radios from interference and jamming in the unpredictable EM environment is critical to our defense capabilities, and has prompted the exploration of wideband tunable circuit architectures to support cognitive radio technology," said DARPA program manager, Dr. Timothy Hancock.

"Unlike narrowband radios that rely on switching between pre-planned filtering and narrowband signal cancellation, today's wideband radios lack the RF front-ends that could help mitigate harmful signals before they reach the sensitive receiver electronics."

The Wideband Adaptive RF Protection (WARP) program seeks to enhance protections for wideband receivers operating in congested and contested EM environments.

The goal is to develop wideband, adaptive filters and analog signal cancellers that selectively attenuate – or cancel – externally generated interference signals (from adversarial jamming, for instance) and self-generated interference signals (like those created by a radio's own transmitter) to protect wideband digital radios from saturation.

Saturation occurs when the power level of a received signal exceeds the receiver's dynamic range – or the range of weak to strong signals it can handle. When exposed to interference or jamming, the target WARP components will sense and adapt to the EM environment through the intelligent control of adaptive hardware.

To address external interference, WARP will explore the development of wideband tunable filters that can continuously sense the EM environment and adapt to maintain the receiver's dynamic range without decreasing signal sensitivity or bandwidth. The research will look at innovative filter architectures supported by state-of-the-art components and packaging to achieve the program's target metrics.

"With the WARP filters, the goal is to reduce the effect of large signals without attenuating smaller signals. By attenuating the large signals, a wideband RF system is better able to listen to both weak and strong signals over a wide bandwidth," noted Hancock.

WARP will also address self-generated inference with the development of adaptive, analog signal cancellers. "Sometimes a system's own transmitter is the biggest interferer to the receiver.

To avoid this issue, transmitting and receiving at different frequencies has traditionally been commonplace, aided by the use of a frequency duplexer to keep the two bands separate. However, for defense systems there are a number of benefits to transmitting and receiving on the same frequency – such as doubling spectrum efficiency and increasing network throughput. This concept is referred to as same-frequency simultaneous transmit and receive (STAR)," said Hancock.

The use of same-frequency STAR has been limited due to few available means of ensuring the transmitter leakage does not interfere with the receiver.

To combat this, WARP will explore analog cancellers that will reduce the transmit leakage before the wideband digital receiver, such that any residual leakage will be sampled and further cancelled in the digital domain.

"Through WARP's technological developments, our ability to reduce critical interference issues and protect wideband radios will significantly improve. Further, if successful, these technologies will enable the use of software-defined radios (SDRs) in congested and dynamic spectral environments – something that is limited today," concluded Hancock.

DARPA is hosting a Proposers Day meeting on February 11, 2020, in Arlington, Virginia, to provide more information about WARP to interested researchers. Find out more at: https://beta.sam.gov/opp/2ebe8f7554af4e4a9ef3b77919af2dd7/view#general

A forthcoming Broad Agency Announcement will include full program details. It will be posted to https://go.usa.gov/xp8UZ

Number 9

Microsoft Releases Security Advisory on Internet Explorer Vulnerability

Cybersecurity and Infrastructure Security Agency (CISA)

Microsoft has released a security advisory to address a critical vulnerability in Internet Explorer. A remote attacker could exploit this vulnerability to take control of an affected system.

According to the advisory, "Microsoft is aware of limited targeted attacks."

The Cybersecurity and Infrastructure Security Agency (CISA) encourages users and administrators to review Microsoft's Advisory ADV20001 and CERT/CC's Vulnerability Note VU#338824 for more information, implement workarounds, and apply updates when available.

Consider using Microsoft Edge or an alternate browser until patches are made available.

Microsoft's Advisory ADV20001, you may visit:
https://portal.msrc.microsoft.com/en-US/security-guidance/advisory/ADV200001

CERT/CC's Vulnerability Note VU#338824, you may visit:
https://kb.cert.org/vuls/id/338824/

Number 10

Mitigating Cloud Vulnerabilities

While careful cloud adoption can enhance an organization's security posture, cloud services can introduce risks that organizations should understand and address both during the procurement process and while operating in the cloud.

Fully evaluating security implications when shifting resources to the cloud will help ensure continued resource availability and reduce risk of sensitive information exposures.

To implement effective mitigations, organizations should consider cyber risks to cloud resources, just as they would in an on-premises environment.

This document divides cloud vulnerabilities into four classes (misconfiguration, poor access control, shared tenancy vulnerabilities, and supply chain vulnerabilities) that encompass the vast majority of known vulnerabilities.

Cloud customers have a critical role in mitigating misconfiguration and poor access control, but can also take actions to protect cloud resources from the exploitation of shared tenancy and supply chain vulnerabilities.

Descriptions of each vulnerability class along with the most effective mitigations are provided to help organizations lock down their cloud resources.

By taking a risk-based approach to cloud adoption, organizations can securely benefit from the cloud's extensive capabilities.

This guidance is intended for use by both organizational leadership and technical staff. Organizational leadership can refer to the Cloud Components section, Cloud Threat Actors section, and the Cloud Vulnerabilities and Mitigations overview to gain perspective on cloud security principles.

Technical and security professionals should find the document helpful for addressing cloud security considerations during and after cloud service procurement

To read more:
https://media.defense.gov/2020/Jan/22/2002237484/-1/-1/0/CSI-MITIGATING-CLOUD-VULNERABILITIES_20200121.PDF

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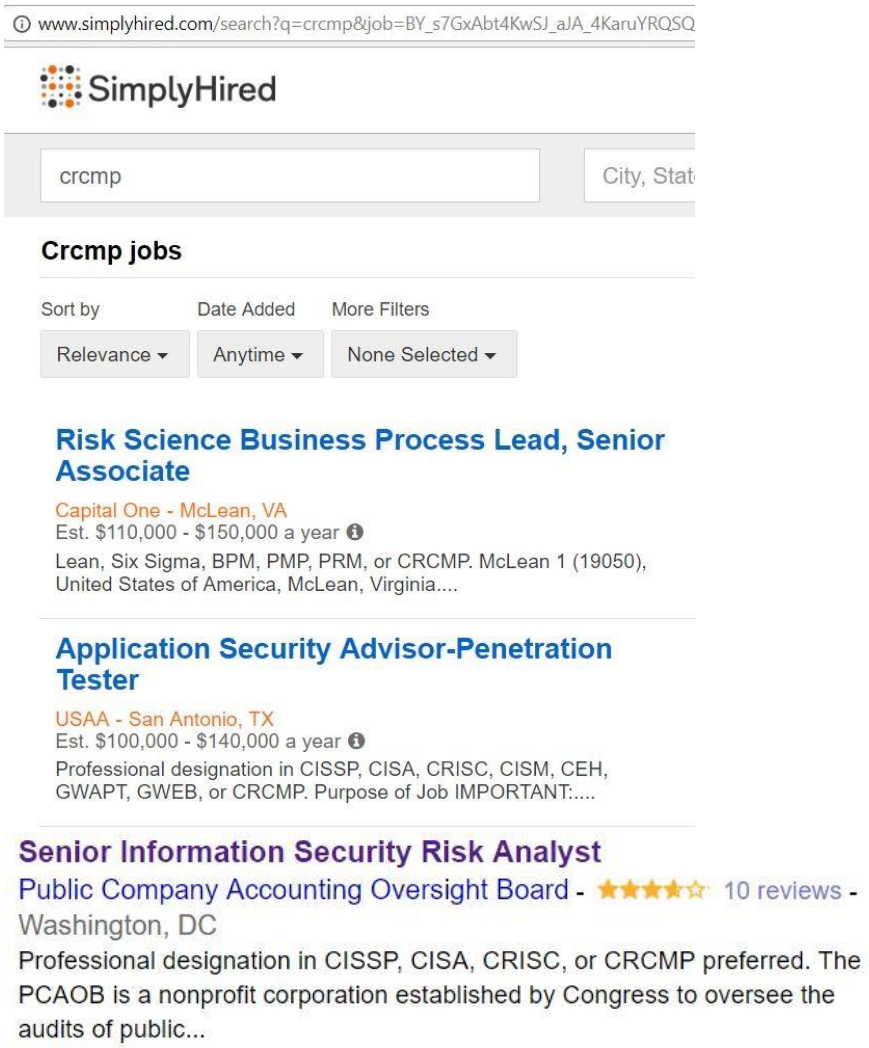

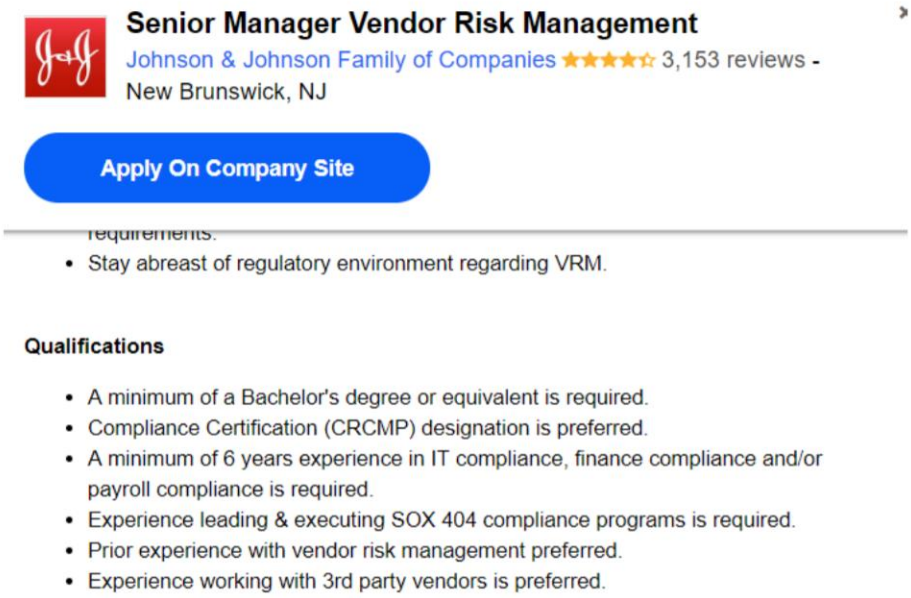

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