The Capital Meets Policy Dialogue™

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EXCERPTS FROM KEYNOTE

THE POLICYMAKER'S PERSPECTIVE

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The FinTech sector presents, potentially, the opportunity to create economies of scale, to facilitate transactions in an instantaneous fashion, and to bring people into the economy who historically have not been able to participate. I have been advocating for and implementing policies to expand opportunities for financial inclusion my entire career, and the potential for DeFi and FinTech makes me generally very hopeful for the future.

But there are challenges that regulators, innovators and investors must confront and address as well. I don't need to describe to this audience the events of last year's "crypto winter", or the concerns that academics, regulators and innovators alike have been raising about the expanded use of AI and machine learning.

How did the events of last year impact a regulator's views of cryptocurrency and FinTech more generally? How is that likely to impact regulation and enforcement?

These are questions that innovators, investors and policymakers alike continue to wrestle with. How should regulators respond?

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At DFS we regulate nearly 100 banks, 17 G-SIBs, thousands of insurance companies, mortgage companies, student lending, pharmacy benefit managers, and others. And we are the only prudential regulator with virtual currency-specific authority in the United States.

We have in place, out of New York's DFS, the most comprehensive virtual currency framework in the United States and perhaps in the world.

Our virtual currency regulatory architecture includes strict licensing, supervisory, and examination standards, as well as enforcement authority. DFS-regulated virtual currency entities are subject to capitalization and reserving, cybersecurity, BSA/AML provisions, and consumer protection requirements. Once licensed, companies are subject to rigorous and transparent pre-approval processes for every new product, new listing, or material change in business. And every licensed company is subject to a bespoke supervisory agreement meant to address its unique risks.

New York's framework has proven its value in terms of consumer protection by shielding New Yorkers from the

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effects of the crypto winter. Neither FTX nor Voyager nor Celsius were licensed to do business in New York. Our framework also provides a vehicle for legitimacy for innovators and investors seeking the kind of clarity of rulemaking that DFS has originated. Our framework has served well to protect consumers, keep virtual currency entities safe and sound, hold bad actors accountable, but importantly, allow for innovation and the marketing of new products compliant with our standards.

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This prudential regulatory approach should be contrasted with an approach based only on penalizing bad actors. Instead, we provide transparency. The first-in-the-nation guidance that DFS put in place sets foundational criteria for U.S. dollar-backed stablecoins issued by DFS-regulated entities. The guidance outlines our expectations with regards to reserves, redemption policies, and independent audits. I have also directed the issuance of new guidance establishing the use of blockchain analytics tools as a best practice for virtual currency entities to prevent and manage risks and suspicious activities, providing companies with an efficient and data-driven way to conduct customer due diligence, transaction monitoring, and sanctions screening.

To carry out this work, the Department has built the nation's leading and most experienced team of virtual currency experts, who examine and supervise licensees to identify and work to ameliorate risks before consumers are harmed and enforcement action becomes necessary. This is not just about regulations and the black and white of the law but a regulator's ability to operationalize. When I came into the Department the virtual currency team was no more than a handful of people and today it is more than 60 professionals, numerous pieces of guidance, assessment authority, and cutting-edge technology that we ourselves use as regulators. One journalist said, "New York used to be the place where crypto went to die. But it turns out that New York is the place where there are no bodies to be found, buried." And our approach has been validated in investment statistics where in 2021 nearly half of private investment in cryptocurrency was in New York-regulated companies, more than 2X Silicon Valley and 8X Miami.

But as we look toward the future, we should learn from the past. We should ask what we can do to ensure that

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these same types of prudential standards that we carry forward in our Bitlicense to protect consumers from harm, are still fostering industry innovation. And of course, that applies as we look to artificial intelligence and machine learning where there are lots of potential benefits, but also risk of harm.

When I say that DFS is looking into AI and machine learning, it is not limited to how we evaluate private sector use of those tools. My vision is for DFS and other regulators to become the "regulator of the future," meaning that we are embracing "RegTech" to the public advantage, using data-driven approaches that leverage data analytics to enhance our ability to predict and respond to events in the marketplace

There are several steps to this process, and questions that we, as a regulator, must ask along the way.

The first part is to procure the hardware that we need to operate these systems and hire professionals with the knowledge and the experience to run the programs.

The next part of the process is questioning how we get the data from our entities that we regulate.

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our entities that we regulate. How do we collect and structure it properly?

All of the major players in private tech and software are moving toward AI, that's no secret, but it would be a missed opportunity for regulators not to make use of these tools as well.

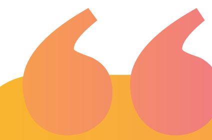
An example of how AI could be used to enhance oversight is of course with blockchain. What data sets.

Of course, blockchain is not the only area where regulators should be using machine learning and artificial intelligence. We're pursuing the use of AI and ML in other contexts as well, from health insurance, to climate, to banking supervision. We're taking steps to use the awesome potential of this technology so that we can more efficiently interact with the public as well as the entities that we oversee.

Most of the guidance out there for artificial intelligence and machine learning—whether we're talking about President Biden's Blueprint for the AI Bill of Rights, or DFS's own circular letter on information sources, or the guidance we've issued on artificial intelligence in underwriting in life insurance—emphasize that safeguards should consider not just the inputs to the system, but the real-life results of machine learning processes.

Here, we should all be concerned not just with the letter of the law, but with the spirit—for example the journey of the consumer through the whole process of buying, or being solicited for a product, as well as the use of that product by the consumer in the marketplace.

When it comes to establishing regulatory frameworks, you would usually see the process go in stages where innovation happens first, and then capital flows, and lastly, regulators respond.



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Now we are in an era where innovators are asking the regulators to help establish the rules of the road as they innovate. We need to consider together where the road is going, how fast can we drive, and what the toll will be.

DFS however is only one regulator, and our responsibility is over banks, insurance companies and crypto firms. And of course, other agencies will have to figure out how they use AI in their oversight and determine how it should be used by the entities they oversee.

But regulators themselves should be innovators. At DFS as I noted we are

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building the regulator of the future, identifying, surfacing and synthesizing data about markets, market breakdowns and market reactions to regulation. This is hard of course in innovative spaces where there is less data to pull from, but that is why we are so committed to stakeholder engagement and working across sectors to surface the information we need to be a powerful regulator.

For regulators must then walk the walk, not just talk the talk, and operationalize the rules we put in place.

It's not enough just to have clarity, with rules and guidance on the books. For regulators must then walk the walk, not just talk the talk, and operationalize the rules we put in place. That is how you strike the balance between protecting markets and consumers, while also allowing for responsible innovation in the marketplace.

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