

# RMA New York 2023 Annual Regulatory Roundtable

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(Clockwise from left) Beth Dugan, deputy comptroller for large bank supervision at the OCC; Carlo di Florio, Global Advisory Leader at ACA Group; Danielle Vacarr, a vice president at the Federal Reserve Bank of New York; Yvonne I. Pytlik, Outsourced Chief Compliance Officer at ACA Group; Michael G. Rufino and Maurya Crawford Keating, associate regional directors of the SEC's New York office.

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## *Emerging Industry Risks and Priorities for Regulators Include AI, Information Flow, and Synthetic Identity Fraud*

A RECENT ROUNDTABLE hosted by RMA's New York chapter brought together regulatory leaders from the OCC, the SEC<sup>1</sup>, and the Federal Reserve Bank of New York.

The emerging industry risks and regulatory priorities were highlighted by the panel, whose conversation was moderated by two executives from the FS industry and ACA Group: Global

Advisory Leader Carlo di Florio and Outsourced Chief Compliance Officer Yvonne I. Pytlik

Pytlik and Di Florio started discussions with a broader theme of regulatory priorities

and industry challenges in continuously evolving financial markets and regulatory expectations. Pytlik noted, “As complexity of banks and financial institutions has been increasing due to technological innovations, new product and novel banking service offerings, and distribution channels, operating and regulatory risks have been increasing as well.”

In a year when industry stress caused much-discussed bank failures, there was naturally talk of interest rate risk, liquidity risk, credit risk, and the like. Those things were still on everyone’s minds.

But when the topic of emerging risks and regulatory priorities came up, a new theme occurred: technology. We all know technology is transforming the banking and securities industries. It’s revolutionizing customer interactions and digital engagement, streamlining operations, and enabling innovative financial services. Digital banking and securities platforms; mobile apps; and online payment, trading, and investment systems are ubiquitous, while artificial intelligence, machine learning, and blockchain are optimizing front to back-office processes, enhancing risk management, and facilitating secure and efficient transactions. Di Florio noted, “As artificial intelligence transforms and disrupts the industry, regulators are keenly focused on ensuring there are effective governance, risk management, and compliance controls to ensure investor protection, market integrity, and safety and soundness of financial institutions.”

## Flow of Information

Beyond the underlying causes of the bank failures, Beth Dugan, deputy comptroller for large bank supervision at the OCC, pointed to the speed at which the failures escalated—and the technologies that fueled such breakneck bank runs—as an area that requires more focus going forward. You had an anxious depositor base who happened to be very tech savvy combined with digital communication and social media platforms that allow news, and rumors, to spread like wildfire.

“I think that sort of caught some people off guard, how quickly it went,” Dugan said. “We’re in a world where everything’s speed, everything’s 24/7. So how do we deal with that? How do we adapt? How do controls adapt? That’s one thing we’ve been talking about.”

## Novel Banking and Securities Activities

Novel banking and securities activities are often technology-driven, unconventional financial services that disrupt and push the boundaries of traditional offerings. Think cryptocurrency, peer-to-peer lending, robo advisers, digital trading platforms, digital engagement practices, and digital wallets.

Danielle Vacarr, a vice president at the Federal Reserve Bank of New York, said such innovations “can result in novel manifestations of risk that hit bank safety and soundness,” but they can also “cause some concerns around the financial system.”

“There’s always a bit of a dance between innovation and regulation,” Vacarr said. “There’s a time where you don’t want to stifle innovation, and then there’s a time where it’s really appropriate to make sure that the risks are balanced. And I would say in this space, I would expect you’d see more particularly on the advisory side from us.”

## Artificial Intelligence/ Machine Learning

Dugan also noted the increased usage of artificial intelligence and machine learning in banking as a topic that warrants increased scrutiny. Yes, these emerging technologies enable banks to process vast amounts of data in real-time, identify patterns and trends, and make data-driven decisions, which can lead to enhanced fraud detection, personalized services, and streamlined back-office operations. But, Dugan said, the risks cannot be ignored.

“Like with any technology there’s good and bad that can come out of it,” Dugan said. “But how do you use it? How do you manage it? That’s what you need to think about.”

And managing it becomes a talent issue. “You and your entities must have the right skillsets, talent, and expertise to truly understand it,” Dugan said.

## Third-Party Risk

With more and more banks and securities firms relying on fintech firms and other third parties, building-in resiliency can be a challenge. Because it’s not

just your organization you need to be worried about. Are your partners resilient? Are their partners resilient?

“It’s increasingly hard to define the financial system in terms of the traditional players,” Dugan said. “That perimeter is just starting to extend and extend and extend. You can outsource an activity. You can’t outsource the risk.”

To that end, Michael G. Rufino, associate regional director in the SEC’s New York office, said “a lot of time and effort” is being put into regulatory technology at the registrants.

“You may know your systems, but how well do you know your vendors’ systems?” he said. “And you’ve heard about third-party risk. What about fourth-party risk? Your vendor outsourcing to another vendor, and the related privacy issues?”

## Digital Engagement Practices

Related to fintech, Maurya Crawford Keating, associate regional director of the SEC’s New York office; said the use of digital engagement practices is “definitely a big issue for us.”

Using technology, data analytics, and user-centric strategies, these practices aim to enhance user experience, increase customer loyalty, and drive specific behaviors, such as investing, saving, or using financial products and services. With this “gamification” of personal finance and investing there is a risk of inadequate risk disclosures, deceptive marketing, or manipulation of investor decisions.

“Starting with many years ago when people had automated financial planning tools, it’s not the system [that’s responsible],” Keating said. “You’re still the adviser. You’re still responsible for that recommendation.”

## Synthetic Identity Fraud

Rufino also said that “fraud is on the rise,” noting two particular types. He said that in synthetic identity fraud, fraudsters combine real and fake information to create difficult-to-detect fictitious identities, which are then used to open fraudulent accounts, establishing a credit history over time. ACATS (Automated Customer Account Transfer Service) fraud, he said, involves unauthorized transfers of customer accounts between financial institutions through deceptive practices, exploiting vulnerabilities in the account transfer process and causing financial harm to customers and institutions alike.

“These are emerging threats because of the ingenuity and the ability to actually know how to bypass firm systems,” Rufino said.

## Critical Role of the Chief Compliance Officers and Chief Risk Officers

RefReflecting on the emerging risks and regulatory priorities, Pytlik noted, “Partnerships between the CCOs and CROs with the senior business leaders are critically important to all firms. They advise senior management teams on critically important compliance and risk

decisions. They mitigate firms’ regulatory risks by creating and testing firms’ compliance policies and procedures, incorporating new or amended regulations, providing technological solutions and best practice recommendations, and other guidelines that may be appropriate to a firm’s operations. Their focal points include conducting risk monitoring and training on emerging and developing regulatory risks.”

## Technology Solutions To Identify and Mitigate Emerging Industry Risks, Meeting Regulatory Expectations

Di Florio noted, “Over the past decade, regulators have invested in cutting edge technology and AI to protect investors, market integrity, and the safety and soundness of financial institutions. The last thing a firm wants is for regulators to come in with their technology tools and find regulatory deficiencies that the firm could and should have identified and remediated themselves if they had invested reasonably in their own regulatory compliance technology and data analytics infrastructure.”

Note:

1. The comments made by Rufino and Keating in this article are provided in their official capacity as the Commission’s Associate Directors of the Division of Examinations but does not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

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