DFI Winter 2021/ 2022 Newsletter

www.dfi.wa.gov

Message from DFI Director Charlie Clark

It has been a while since our last newsletter, and we have made some changes at DFI. On Oct. 18 we opened the Tumwater Office once again to the public. While we have been serving the public online and via the phone, we are very happy to have our doors open for folks who choose to visit our headquarters. We implemented the Governor's vaccine mandate and have a fully vaccinated workforce in the office. Currently we require masks in the office as is recommended by local and state health departments.

Due to our ability to successfully work remotely, we consolidated our offices into one office in Tumwater, and closed our Seattle Office in November of this year. Our bank examiners will be assigned home offices and will also have touch down spaces in Tumwater when needed. Our Division of Banks will also have some space in the Tumwater Office as they have always had. We are also working on providing them with occasional meeting space in Seattle.

This year a long time member of our Executive Team, Joe Vincent, retired. While we lost a key member of our Executive Team and a true banking expert, we are happy to announce the hiring of a new attorney to fill his position, Ali Higgs. We were very lucky to hire Ali because she is also a true banking expert! Ali is not new to DFI as she served the agency as a banking examiner before becoming an attorney, and then as an attorney worked as a DFI program manager in our Division of Banks. After that she worked as a compliance consultant in the financial services industry. Since she has returned, she hit the ground running working on our Center for Fintech Information. We have put her in charge of our internal Fintech workgroup. Along with our internal Fintech team, she has updated our website, and coordinates DFI responses to industry from the Center. If you are curious about the DFI Center for Fintech Information and want more information, take a look at our article in this newsletter. You can also listen to a hearing where the DFI Center for Fintech Information staff made a presentation to the Senate Committee on Business, Financial Services, & Trade, available here at about the 39 minute mark.

We are also excited about the hiring of our new Director of Diversity Equity and Inclusion at DFI, Erin Lopez Nielson. We want to work with you together as we make Washington a more diverse, equitable and inclusive marketplace to do business. We know there is a lot of work to do in this area, and we encourage you to reach out to Erin, or to me to discuss any ideas you have as we begin this important work in 2022.

I wish all of you a Happy Holiday Season, and Best Wishes for the year ahead,
Charlie Clark

Spotlight on Financial Technology

DFI Updates Center for FinTech Information Website

DFI announced the launch of the Center for FinTech Information (CFI) in May 2021. The CFI was created to facilitate communication between DFI and entrepreneurs, start-ups, and FinTech companies that wish to enter the financial services space.

Based on industry feedback, we launched an updated CFI website on Dec. 1 to include more user-friendly information and tools. Website improvements include: adding staff contact information, adding a comprehensive FinTech timeline, and providing a high-level decision tree.

A major component of the CFI is to review business concepts or plans to assist a new business in identifying potential activities that may be regulated by DFI. The CFI provides information about doing business in Washington as a regulated entity under DFI's financial laws, rules, and regulations, including those related to money transmission, lending, securities, and banking. The CFI site also has comprehensive regulatory guidance and information for industry participants, consumers, and investors.

The CFI can be reached by contacting Ali Higgs, Director of Regulatory and Legal Affairs, by using the dedicated CFI email address FinTechInfo@dfi.wa.gov or by phone at (360) 902-0516.

Emerging Risks – with a focus on Information Technology and Cyber Risks

As we move into the final few months of 2021, financial institutions can turn their attention to some of the top emerging risks. When the Conference of State Bank Supervisors (CSBS) asked the Western Regional Regulators their most significant concerns in January 2021, the top concerns were cybersecurity, credit quality impacts from the pandemic, the potential impact from the end of consumer and SBA relief programs, and climate change. Similarly, The American Bankers Association (ABA) Banking Journal discusses the impact of margin pressure from low interest rates, risks to commercial real estate, and cybersecurity as the top three risks facing banks in the coming years, along with compliance and operational risks as the industry continues to become more digital.

Information technology (IT) and cybersecurity have consistently remained a growing concern for bankers and regulators. IT Risk management efforts may be lacking in some banks; the Federal Reserve Board (FRB) noted that there has been an increased level of IT-related enforcement actions. Similarly, smaller community banks may be more challenged to attain sufficient IT expertise and resources.

Most states have stated there is increasing risk in IT, and many states are addressing the increased risk by expanding their IT examinations staff and training programs. The Washington Division of Banks continues to perform full-scope IT examinations as part of our safety and soundness bank examination program, and we maintain strong expertise in our IT examination staff.

Emerging Risks Continued...

Recent cyber threats that have required industry identification and mitigation efforts include the December 2020 SolarWinds breach and the zero-day vulnerabilities in Microsoft's Exchange Servers. DFI also completes various levels of industry outreach when these events occur to notify our regulated entities and assess impacts and responses.

Cybersecurity incidents directly impacted a small number of Washington banks , but those banks took appropriate steps to mitigate the risk. To assess the full impact of potential future cyber events, banks should communicate with their third party vendors as soon as possible to determine their full exposure.

IT issues identified in the state of Washington have primarily been associated with third party risk management, IT audit and independent review, and IT governance. Managing third-party risk continues to expand because of the growth of digital banking and remote work arrangements. Institutions should increasingly assess where data is going and who's managing it.

Further, banks may be overlooking risks of remote access because of the need to quickly expand remote access systems to their employees. An increase in remote users may result in a bank having less control over sensitive information, and institutions should proactively manage that added risk. Overall, bank management should continue to prioritize oversight of current and emerging risks, in particular the ever-growing risks in the cybersecurity space.

FinTech and DFI's Division of Credit Unions

While it's true that cryptocurrency holders do not need financial institutions to access their assets, credit unions can provide opportunities to facilitate the experience and help retain the market share. As cryptocurrency has continued to gain interest and we see younger generations begin using alternative tech firms for their financial needs, digital assets are another area for both credit unions and regulators to consider.

The Department of Financial Institutions (DFI) continues to expand its knowledge surrounding financial technology and created a workgroup in 2017 to discuss how innovations can and have impacted the financial industry. Representatives from each regulatory division meet monthly and discuss various topics, including each division's own chartering requirements, licensing laws, current regulation, and how FinTech business models may (or may not) fit into the existing regulatory framework. The purpose of the group is to share information cross-divisionally in an effort to stay abreast of this quickly-evolving topic. Amy Hunter, Division of Credit Unions (DCU) Director represents the DCU on this workgroup.

National Credit Union Administration (NCUA) also has their radar on this topic as Kyle Hauptman mentioned during his swearing-in ceremony in December 2020 the expanding the role of technology is a priority. To better understand the current and potential impact of activities connected to digital assets and related technologies, the NCUA recently published a request for information (RFI) in the Federal Register that encourages credit unions and industry stakeholders to provide information on the impact of these assets and technologies related to credit unions.

The RFI poses questions regarding the use of digital ledger technology and decentralized finance applications within the credit union system; risk and compliance management; supervision; and share insurance and resolution. This RFI echoes a recent request from the Federal Deposit Insurance Corporation (FDIC) regarding current and potential digital asset activities in depository institutions.

The National Association of State Credit Union Supervisors (NASCUS), an organization that the Division of Credit Unions has been a member of for many years, has also been following the developments with digital assets and technologies. NASCUS recently hosted a webinar entitled "Virtual Currencies and Digital Assets" that covered many aspects of cryptocurrency and how it is regulated (or not) at the state, federal and international level.

Recent Stock Market Volatility Causes Investor Outrage and Raises Regulatory Issues

Numerous small trades in GameStop and a number of other stocks sparked stock market volatility earlier this year. Reddit and other social media platforms promoted these trades. Most of the trading was done on trading platforms of broker-dealers that offer free trades. These broker-dealers are paid for the order flow they send to firms that fulfill the orders. Without the order flow payments, these broker-dealers would be unable to offer free trades.

The broker-dealers on whose trading platforms the trades were made had to restrict trading in the stocks until they raised the additional capital required by their clearinghouses. This caused traders to complain to DFI's Securities Division, as well as to various other authorities. Many of those complaining were relatively new to trading. Their complaints focused on limitations on stock purchases imposed by their broker-dealers. However, the inquiries about what happened and how it happened extend far beyond the broker-dealers and their trading platforms. Who were those touting trading in GameStop and the other stocks? Did they have any conflicts of interest that might have led them to encourage others to buy the stock?

Congress has conducted hearings on the market volatility. Various securities regulators are investigating aspects of this trading event. There has also been renewed discussion of the practice of payment for order flow as well discussion about the gamification of trading on some of the newer trading platforms. Whether or not Congress takes any action as a result of its hearings, regulatory agencies such as the United States Securities and Exchange Commission and FINRA (the self-regulatory agency for the securities brokerage industry) may well take action in response to recent market volatility.

Modernization Efforts in the Non-Bank Space

The Future of Non-Depository Supervision is Now

Some exciting efforts are occurring in the non-bank financial regulation space. We have been closely involved in two initiatives that are rolling out nationwide: Networked Supervision and the State Examination System.

What is "Networked Supervision"?

Networked Supervision aims to transform a 50-state system into an inclusive national system using common policies to prioritize work based on risk and resource availability. States are coordinating efforts more than ever before, aiming to support a strong, efficient, and assertive state system of financial regulation.

If you'd like to read more about what state regulators are doing as part of Networked Supervision, see the following links:

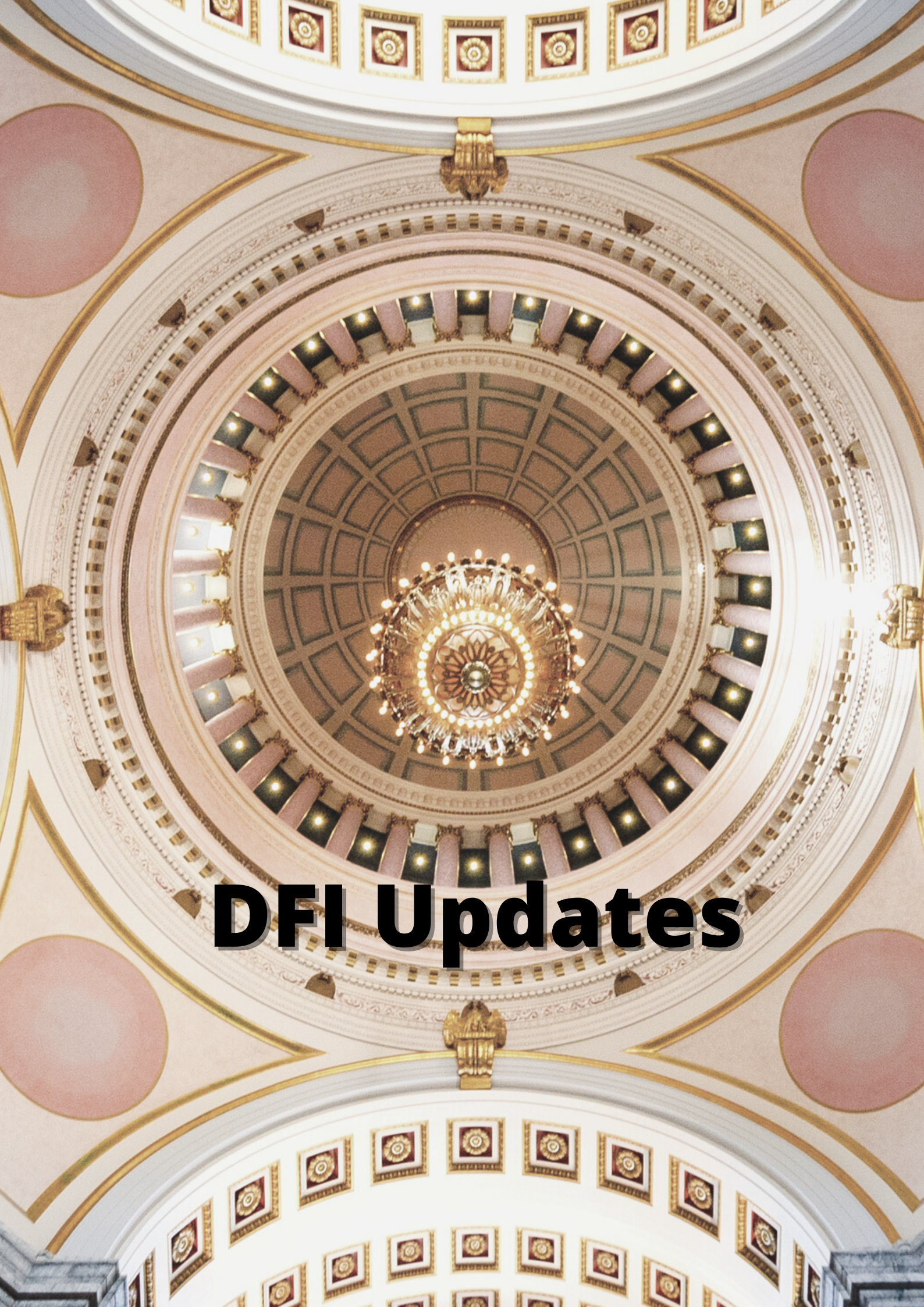
https://www.csbs.org/newsroom/networked-supervision-opportunity-regulatory-change

https://www.csbs.org/newsroom/large-fintechs-and-other-payments-companies-move-single-exam-nationwide-regulatory

Early efforts for networked supervision started with the money services businesses (MSB) industry. We were instrumental in the creation of the Multistate MSB Licensing Agreement (MMLA) Program and continue to serve as the lead state administering the program. The Nationwide Multistate Licensing System (NMLS) is using the MMLA Program as a model as it builds the modernized NMLS (which will be launched in 2022, starting with the MSB industry). This year, we are also leading a number of the national multi-state examinations planned as a part of the networked supervision efforts.

What is "the State Examination System"?

Otherwise known as "SES" – SES is an examination system built by state regulators for state regulators and the companies they supervise. It is the only nationwide system connecting agencies and companies in the examination process. We are looking forward to piloting the State Examination System (SES) later this year. The new online platform is designed to bring state regulators and companies into the same technology space, fostering transparency and collaboration, and reducing redundancy. Check out the About SES page for more information.



DFI Updates

DFI Welcomes New DEI Director Erin Lopez Nielsen

We are pleased to announce the arrival of Erin Lopez Nielsen, DFI's new Director of Diversity Equity and Inclusion (DEI).

Lopez comes to us with more than two decades of DEI experience working with organizations and agencies and hit the ground running. In her first few weeks, she helped us connect with community organizations, been added to statewide committees focused on equity, assessed areas of impact available to us, and is keeping us focused on increasing our DEI efforts – both internally and externally. Her passion for, energy toward and commitment to DEI work is evident in her already immense engagement in all aspects of DFI's operations.

"I am excited to join you as the first Director of Diversity, Equity, and Inclusion. To me, this role provides the rare opportunity to align my lifelong passion for equity with my background in finance and economic development. I look forward to collaborating and learning from each other to create a better financial future for all Washingtonians by bringing in diverse perspectives and innovating to lead change. While in an industry with high regulations and requirements, it is through leaning into curiosity and sharing your perspectives that good ideas can move to reality. Success to me is remaining the premier agency people want to work for and celebrating in a financial system all Washingtonians can enjoy participating in."

Reporting Suspected Financial Exploitation of Vulnerable Adults

Financial institutions in Washington can refuse to disperse funds when they suspect financial exploitation of a vulnerable adult is being attempted, may have occurred, or may have been attempted. Financial institutions are not required to place a hold and may use discretion to determine whether to do so. If a financial institution decides to place a hold, it must make a report to adult protective services ("APS") and law enforcement and make reasonable efforts to notify all persons associated with the account. When a securities transaction is involved, the Securities Division would also appreciate being notified. You can notify the Securities Division by filing a complaint or by contacting Kristen Standifer at 360-902-8760. Complaints may be filed online.

In addition, financial institutions located in Washington are required to train employees who have contact with customers and access to account information on a regular basis. For more information, see Washington's financial exploitation of vulnerable adults statute, RCW 74.34.215 and RCW 74.34.220.

FINRA Panel on Communication Between APS and Professional Reports of Financial Exploitation

FINRA recently released a virtual conference panel on Communication between Adult Protective Services (APS) and Professional Reporters of Financial Exploitation. Panelists include Akiles Ceron, the program director of the San Francisco APS; Kyle Innes, the Associate Director of State Government Affairs at FINRA; Debbie Noury, the senior director of the Elder Financial Investigations team at Fidelity Investments; and a licensing and examination supervisor for DFI's Securities Division, Kristen Standifer. The panelists explore the evolving regulatory structure surrounding senior investor protections and the challenges facing financial services professionals when developing an effective, efficient, and integrated protection framework.

The topics discussed include how APS operates, the nuances of reporting, how firms monitor for financial exploitation, training programs, the challenges of communication between APS and firms, and the advantages of reporting to state securities regulators even when not required to do so.

You can view the panel online.

SEC Amends the “Accredited Investor” Definition Used in Exempt Securities Offerings

The majority of capital raised in the United States is raised in unregulated offerings to “accredited investors” under the exempt offering rules adopted by the federal Securities and Exchange Commission (“SEC”). The term was first defined in 1982 and has remained largely unchanged until recently when the SEC expanded the definition to include additional categories of individuals and entities. The amended definition will allow additional individual and organizational investors to participate in exempt offerings that are not subject to meaningful regulatory oversight or financial reporting obligations.

Since 1982, an individual has qualified as an “accredited investor” on the basis of the individual’s income or net worth. To meet the definition, an individual had to have either:

- A net worth in excess of $1,000,000; or
- Income in excess of $200,000 in each of the two most recent years, or joint income with that person’s spouse in excess of $300,000 in each of those years, and a reasonable expectation of reaching the same income level in the current year.

While these financial thresholds have never been adjusted for inflation, the SEC amended the definition to provide that an individual’s net worth does not include the value of the person’s primary residence as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Accredited Investor Continued….

As a result of the SEC's most recent amendments to the definition, the following additional categories of natural persons qualify as accredited investors:

- Holders of certain professional certifications, designations, or credentials from an accredited educational institution that the SEC has designated by order. Concurrent with the amendments to the definition, the SEC entered an order designating holders of the Series 7, Series 65, or Series 82 licenses as accredited investors.

- So-called "knowledgeable employees" of a qualifying private fund or an investment adviser to a qualifying private fund with respect to offerings of that fund's securities; and

- "Family clients" of "family offices" that have at least $5 million in assets under management.

The categories of entities that qualify as accredited investors was expanded to include:

- SEC and state-registered investment advisers, as well as exempt reporting advisers;

- Rural business investment companies (RBICs);

- LLCs with total assets in excess of $5,000,000;

- Any entity not previously included in the definition that owns investments in excess of $5,000,000 provided that it was not formed to invest in the securities offered; and

- "Family offices" with assets under management in excess of $5,000,000.

- The amendments to the definition became effective Dec. 8, 2020.

Accredited Investor Definition, SEC Release Nos. 33-10824, 34-89669 (Aug. 26, 2020), available at https://www.sec.gov/rules/final/2020/33-10824.pdf.

Net Worth Standard for Accredited Investors, SEC Release Nos. 33-9287, IA-3341, IC-29891 (Dec. 21, 2011), available at https://www.sec.gov/rules/final/2011/33-9287.pdf.

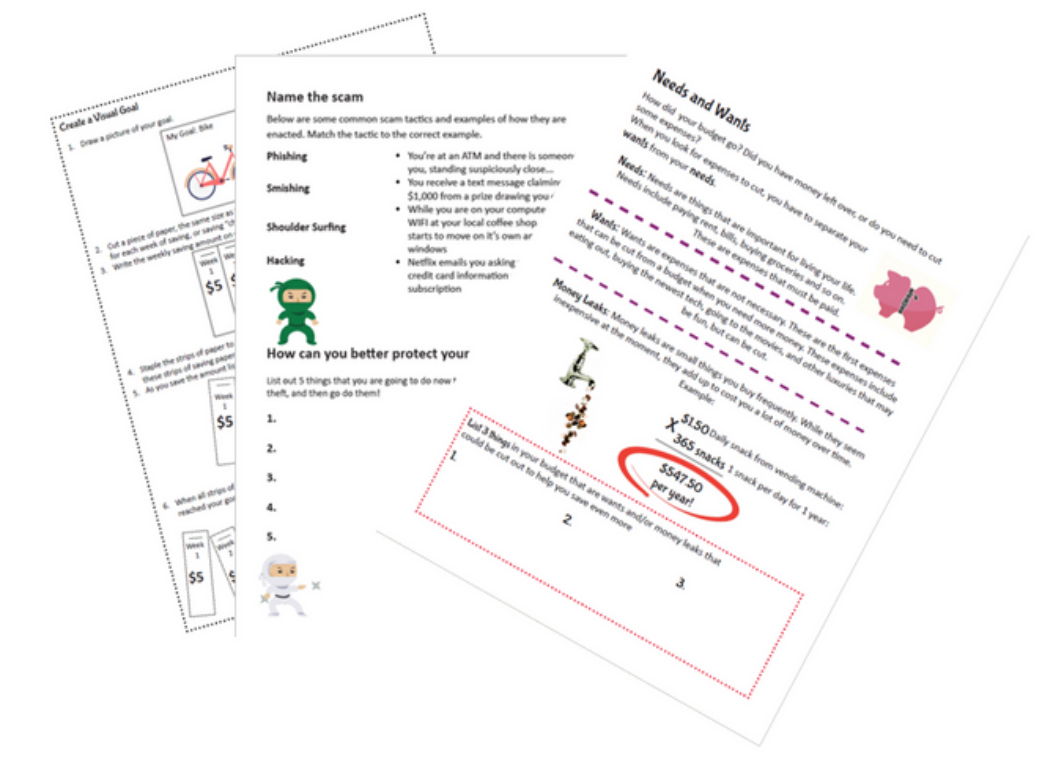
DFI Expands Online Financial Education Resource Page for At-Home Learning

When the pandemic sent us all home back in March 2020, DFI's Webmaster stepped up to the plate and made sure teachers and parents had access to financial education resources online to supplement their at-home education. Since March 2020, that site (https://dfi.wa.gov/financial-education/educators/at-home-materials) continued to grow as new resources were developed and discovered.

Recognizing we may all be home for some time to come, DFI's Communications & Financial Education Outreach team began building on this site, creating new resources and grouping them into grade-appropriate packages appropriate for a variety of learning styles.

The updated site now offers printable worksheets, videos, games and more – all sorted into grade/age-appropriate packages.

We will continue to update the site with new resources as we find them. In particular, we hope to include resources designed for underserved populations, students with special needs, and students for whom English is a second language.



Let's Get Social: DFI Launches New Social Media Accounts

The DFI's Communications team regularly seeks new ways to share information. This year, we've launched two new social media accounts to add to our existing Twitter, Facebook and YouTube accounts.

If you aren't following DFI on Instagram and LinkedIn, please consider doing so – give us a like, and share!