Davis Polk

# Financial Services Regulatory Reform

## WINTER FORECAST EDITION

February 2, 2022

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**This publication is one of three that we will update from time to time on key areas of policy development that are likely to affect the financial services industry. Our companion publications address Climate Regulatory Reform and the U.S. Financial Services Sector and U.S. Digital Asset Regulatory Reform.**

The evolving landscape

# Financial regulatory leadership as of February 2, 2022

## Treasury


Secretary Yellen


Deputy Secretary Adeyemo


Under Secretary for Domestic Finance Liang


Under Secretary for Terrorism and Financial Intelligence Nelson


Assistant Secretary for Financial Institutions Steele

Under Secretary for International Affairs

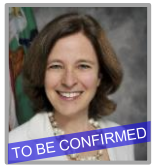
## Federal Reserve

Chair Powell*

Vice Chair Brainard*


Governor Bowman


Governor Waller



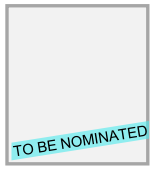
Vice Chair for Supervision Raskin*

Governor Cook*

Governor Jefferson*

## FDIC

Chairman McWilliams



Vice Chairman

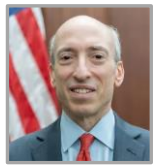
Director Gruenberg**


CFPB Director Chopra

Comptroller

Acting Comptroller Hsu

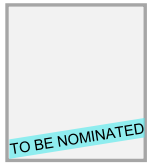
## SEC


Chair Gensler


Commissioner Lee


Commissioner Crenshaw


Commissioner Peirce



Commissioner

## CFPB


CFPB Director Chopra

## OCC

Comptroller

Acting Comptroller Hsu

## CFTC


Chairman Behnam

Commissioner Stump

Commissioner Goldsmith Romero

Commissioner Johnson

Commissioner Mersinger

Commissioner Pham

* Chair Powell is awaiting re-confirmation as Chair of the Federal Reserve. Governor Brainard is awaiting confirmation as Vice Chair. Sarah Bloom Raskin has been nominated as Vice Chairman for Supervision. Lisa Cook and Philip Jefferson have each been nominated as a Governor of the Federal Reserve.

** Upon Chairman McWilliams' departure, Director Gruenberg will become Acting Chairman of the FDIC.

# Consumer financial protection





**General outlook**

- CFPB Director Chopra began his tenure in mid-October 2021. In Director Chopra's inaugural testimony before the House Financial Services Committee (HFSC) and Senate Banking Committee (SBC) in late October 2021, and in later CFPB actions and reports, Chopra has prioritized:
  - Heightened focus on the actions of large technology companies, with an emphasis on data privacy
  - Fostering economic competition in consumer financial markets
  - Increased enforcement efforts, which would build on the existing upward trend, with a focus on repeat offenders that are in violation of agency or federal court orders and larger market participants
  - Enhanced scrutiny of higher education lenders, servicers and debt collectors and forbearance of federal student loans
  - Focusing on small dollar lending practices and underwriting standards
  - Bolstering protections against abusive debt collection practices, with a particular focus on overdraft fees
  - Monitoring consumer use of digital assets
  - Evaluating how buy now, pay later products impact consumer debt, data privacy and regulatory arbitrage

# Consumer financial protection





- In the **Fall 2021 Unified Regulatory Agenda**, the CFPB also signaled near-term activity in areas including:
  - Reducing bias in credit reporting practices.
  - Joint rulemaking with the federal banking agencies to implement quality control standards for automated valuation models
  - Enabling consumer data access, as further discussed in the Open banking and data access section at slides 57 and 58
- For information on the CFPB's initial steps to evaluate payments activities of certain large technology companies, see slide 58 in the Open banking and data access section.

**UDAAP:** Section 1036 of the Dodd Frank Act specifies that "it is unlawful for any provider of consumer financial products or services or a service provider to engage in any unfair, deceptive or abusive act or practice (UDAAP)."

- The definition of "abusive" remains a continuous topic of debate, and Chopra's Congressional testimony suggests that he intends to clarify that definition through enforcement rather than regulation.
- At an American Bar Association panel on January 6, 2022, CFPB Acting General Counsel Seth Frotman stated that "across the board, the [CFPB] will be closely monitoring the markets it oversees to ensure that institutions are not engaging in discriminatory practices that are unfair, or indeed deceptive, or abusive, as well as continuing to ensure practices do not violate any other laws we enforce…"

# Consumer financial protection





**Bank fees RFI:** The CFPB issued a broad-ranging request for information (RFI) on January 26, 2022 about fees charged by banks, credit unions, mortgage lenders and fintechs on financial products including bank accounts, credit cards, mortgages and student loans. Comments are due by March 31, 2022.

- The CFPB is interested in hearing about consumers' experiences with fees, including fees for products and services consumers believed were covered by the baseline price of a product or service; unexpected fees for a product or service; fees that seemed too high for the purported service; and fees where it was unclear why they were changed.
- The RFI states that " the CFPB is concerned about fees that far exceed the marginal cost of the service they purport to cover, implying that companies are not just shifting costs to consumers, but rather, taking advantage of a captive relationship with the consumer to drive excess profits."
- In the accompanying blog post, the CFPB stated the goal of its initiative to "save households billions of dollars a year by reducing exploitative junk fees charged by banks and financial companies," and announced its intention to "strengthen competition in consumer finance by using its authorities to reduce these kinds of junk fees."

# Consumer financial protection





- Previously, in a December 1, 2021 discussion of overdraft fees, CFPB Director Chopra asserted that "upfront pricing that appears to be 'free,' but is offset by opportunistic penalties that take advantage of complex rules and captive customers, is not the sign of a competitive market."
  - CFPB Acting General Counsel Seth Frotman quoted that statement at a January 6, 2022 American Bar Association panel and went on to remark that "these concerns are limited to just overdraft, but a range of similarly situated fees we see across products. There are clear market failures here, and the bureau will ensure that markets for consumer financial products are fair, transparent, and competitive."
- In a January 29, 2022 response to the CFPB's RFI, the Bank Policy Institute and a coalition of financial trade associations termed the RFI "a misguided effort that paints a distorted and misleading picture of our country's highly competitive financial services marketplace." The joint statement goes on to note that "[m]ultiple federal laws and the CFPB's own rules already require banks, credit unions and other providers of consumer financial services to disclose terms and fees in a clear and conspicuous manner..."

# Disparate impact





**Fair lending:** In January 2022, CFPB Acting General Counsel Seth Frotman confirmed that the CFPB "will continue to bring significant fair lending actions under the Equal Credit Opportunity Act."

- The CFPB has allocated double the examiner capacity for fair lending related supervisory work for the 2021/2022 exam calendar year compared to the prior year, resulting in a 100% increase in supervisory work related to racial equity.
- The CFPB's fair lending enforcement focus will include but not be limited to racial discrimination.
  - In September 2021, the CFPB issued a long-awaited proposed rule under Section 1071 of the Dodd-Frank Act that would require lenders to report information to the CFPB on the amount and type of small business credit applied for and extended, demographic information about small business credit applicants (minority-owned business status, women-owned business status, and the ethnicity, race, and sex of the applicant's principal owners), and key elements of the price of the credit offered. The resulting database would facilitate fair lending enforcement. The deadline for comments was January 6, 2022.
- The CFPB may issue a rule or guidance clarifying its approach to disparate impact analysis under the Equal Credit Opportunity Act (ECOA) and/or Regulation B, as the CFPB suggested in a July 2020 request for information.
- In December 2021, the CFPB, FTC, DOJ and Federal Reserve Board filed an amicus brief in the Seventh Circuit urging the court to broadly interpret the definition of "applicant" under ECOA and Regulation B. The CFPB and FTC filed a similar amicus brief in the Second Circuit in October 2020.

# Disparate impact





**Fair housing:** HUD issued two rules in June 2021 following an Executive Order from President Biden directing HUD to examine the effects of two Trump Administration rules.

- An interim final rule that went into effect in July 2021 repealed the Trump Administration's 2020 Affirmatively Furthering Fair Housing (AFFH) rule and restored certain definitions and certifications from the Obama Administration's 2015 AFFH rule. The interim final rule does not reinstate the standardized assessment that was required under the 2015 AFFH rule. HUD will issue a separate proposal on a new fair housing planning process and framework.
- A proposed rule would repeal the Trump Administration's 2020 rule on disparate impact standard under the FHA and recodify the discriminatory effects standard from the Obama Administration's 2013 rule. The Trump Administration's 2020 rule, which would have introduced more stringent pleading requirements for plaintiffs making disparate impact claims, was due to go into effect in October 2020 but was stayed by a Massachusetts federal district court ruling. Comments were due on the proposed rule by August 24, 2021.
- **Fair housing enforcement actions:** In October 2021, the CFPB, DOJ and OCC all brought enforcement actions against Trustmark National Bank for violations of the FHA. Announcing the DOJ enforcement action and its Combatting Redlining Initiative, Attorney General Garland said the DOJ will "spare no resource to ensure that federal fair lending laws are vigorously enforced and that financial institutions provide equal opportunity for every American to obtain credit." The DOJ brought another enforcement action for violations of the FHA in January 2022, and we expect more enforcement actions to be forthcoming.

# Disparate impact





- **Discrimination in mortgage lending:** In November 2021, the CFPB issued a request for information to seek input on rules implementing the Home Mortgage Disclosure Act (HMDA). The CFPB plans to review recent changes to the rule and their effectiveness, with the goal of strengthening its ability to maintain a fair, competitive and non-discriminatory mortgage market. The request for information follows several CFPB and HMDA reports that found mortgage lenders more often deny credit and charge higher interest rates to non-white applicants than to white applicants. Comments were due on January 21, 2022.

**Federal Reserve Racial and Economic Equity Act:** In April 2021, the HFSC approved a bill introduced by Chairwoman Waters that would require the Federal Reserve to exercise all its duties and functions in a manner that fosters the elimination of disparities across racial and ethnic groups with respect to employment income, wealth and access to affordable credit. The same month, Senators Warren and Gillibrand introduced a Senate version, which has been referred to the SBC.

# Disparate impact





**Home appraisals:** The Biden Administration and various agencies have indicated that addressing racial disparities in home appraisals is a key goal. We expect to see rulemaking and potential executive action in this area.

- In June 2021, the Biden Administration announced, as part of its strategy to address the racial wealth gap, "a first-of-its-kind interagency effort to address inequity in home appraisals, and conduc[t] rulemaking to aggressively combat housing discrimination."
- The first meeting of the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE), chaired by HUD Secretary Marcia Fudge and Domestic Policy Council Director Susan Rice, took place in August 2021. The PAVE members agreed that the body will focus on four principal goals:
  - Ensuring that government oversight and industry practice further valuation equity
  - Combatting valuation bias through educating the consumer and training the practitioner
  - Ensuring equity in valuation by making available high-quality data
  - Creating a comprehensive approach to combating valuation bias through enforcement and other efforts

# Disparate impact

- PAVE is expected to deliver a final action report in early 2022.
- Acting Comptroller Hsu has separately emphasized that under his leadership, addressing inequality will be a top OCC priority. He has also emphasized the need to eliminate racial bias in home value appraisals and indicated support for enforcement actions against banks that use discriminatory appraisals.
- Acting FHFA Director Thompson has emphasized the FHFA's commitment to short-term appraisal flexibilities to keep the mortgage market functioning and has announced that the FHFA has been reviewing the data gained from the use of these flexibilities and in responses to their appraisal RFI.
- In November 2021, HUD released Mortgagee Letter 2021-27, which reinforced HUD's and FHA's commitment to preventing racial bias in the valuation of single family properties by clarifying the requirements for the compliance with the Fair Housing Act requirements. Among other things, the letter clarifies that no part of the appraisal analysis or reporting may be based on any basis prohibited by federal, state, or local law, such as race, religion and sex.

# AI and alternative data





**AI and alternative data:** The major financial regulators have issued a request for information on the use of AI and alternative data. The request includes multiple questions on AI and fair lending, including on the risks that AI can be biased and/or result in discrimination on prohibited bases. The comment period closed, after extension, on July 31, 2021. In December 2021, the CFPB made a specific request to engineers, data scientists and others who have detailed knowledge of AI's potential discriminatory effects to come forward with information. Otherwise, no related announcements have been made since by the major financial regulators.

- The National Community Reinvestment Coalition and six fintech companies submitted a letter to the CFPB requesting guidance on how the CFPB will apply ECOA and Regulation B to systems that use AI or alternative data to make lending decisions. Among other things, the letter recommends that the CFPB align Regulation B's "legitimate business need" standard to HUD's 2013 discriminatory effects rule.
- **For more detailed discussion and analysis of the major financial regulators' focus on AI and machine learning, our client memorandum is available here.**
- While announcing the FHA enforcement actions discussed earlier, CFPB Director Chopra made clear that "the federal government will be working to rid the market of racist business practices, including those by discriminatory algorithms." We expect the enforcement actions to continue.
- **AI Bill of Rights:** In October 2021, the White House Office of Science and Technology Policy (OSTP) announced that it would develop an AI Bill of Rights. As a first step in related public engagement, OSTP issued a public request for information on use of biometric technologies.

# Underbanked and basic access





**Banking access:** The following are some of the most prominent proposals to increase banking and financial services access.

**Banking for All Act:** SBC Chairman Brown has supported the Banking for All Act, but it has not been brought to a vote. The Banking for All Act would require Federal Reserve member banks to offer direct digital U.S. dollar accounts to all U.S. individuals and businesses.

- Banks would be required to offer certain minimum banking services on terms no less favorable than those that the bank offers for existing transaction accounts, provide a minimum interest rate and not charge account fees or have minimum or maximum balance requirements.
- In areas with limited access to Federal Reserve member banks, banks would be required to partner with U.S. Postal Service retail facilities to provide access to accounts.
- Although the Banking for All Act and similar bills in the House have been introduced or included in early drafts of other legislative packages by several members of Congress, none have actually proceeded to a vote. We think it is unlikely that any of these bills will be considered by any committee in the near term.

# Underbanked and basic access





**Postal banking:** Although we believe that postal banking is unlikely to gain traction, several Democrats in both the Senate and the House are vocal proponents, including Senators Sanders and Warren. Short of full postal banking, the U.S. Postal Service could be leveraged to facilitate access to other programs, as was proposed in the Banking for All Act. 33 House members voiced support for including postal non-bank financial services pilot programs in the fiscal year 2022 Appropriations Bill.

**Public banking:** Today, only one state-owned bank exists, in North Dakota, but there has been a movement by some on the progressive left to expand state and locally owned and operated public banks.

- In 2019, California passed legislation that allows California counties and cities to create public banks, and in late March 2021, introduced a bill for the California Public Banking Option Act, with the goal of providing a "zero-fee, zero-penalty public option for basic financial services." Several California counties are exploring a partnership to jointly open a "Central Coast" public bank.
- Several other states have also introduced bills to permit chartering of public banks. At the federal level, Representatives Tlaib and Ocasio-Cortez introduced a bill for the Public Banking Act, which would promote the chartering of state and local public banks.

# Underbanked and basic access

**Green banks**: Among other proposed legislation concerning green banks, as part of the American Jobs Plan, the Biden Administration has proposed the establishment of a $27 billion Clean Energy and Sustainability Accelerator to mobilize private investment into distributed energy resources; retrofits of residential, commercial and municipal buildings; and clean transportation. The Biden Administration explained that "[t]hese investments have a particular focus on disadvantaged communities that have not yet benefited from clean energy investments."

- Funds for the Accelerator were not included in the Infrastructure Investment and Jobs Act but are included in the $3.5 trillion budget resolution passed by the Senate in August 2021. The Accelerator's implementation depends on whether it remains in any Build Back Better legislation and whether the bill becomes law.

**Private sector response**: Although federal legislative proposals to require banking access are unlikely to be passed in the current environment, the private sector is starting to voluntarily embrace some of these ideas. For example, banks representing 52% of U.S. deposits offer accounts certified by the Cities for Financial Empowerment Fund's Bank On program, and which charge low or no fees and do not charge overdraft fees.

# Underbanked and basic access





**Fintech and innovation**: The Chief Innovation Officers at both the OCC and CFTC have stated that their agencies will be thinking about how technological innovations can help the underbanked and unbanked, as well as address other structural issues that present barriers to expanded financial inclusion.

The FDIC is similarly focused, launching in July 2021 a technology-focused challenge that encouraged banks, nonprofits, academic institutions and others to identify better resources to help underbanked Americans. Eight organizations participated and assisted the FDIC in developing various solutions to the problem statement.

**FDIC #GetBanked campaign and collaboration with Operation Hope:** The FDIC has launched a public awareness campaign about the benefits of opening a traditional bank account. Focusing on U.S. households without a bank account, the campaign is initially focusing on the Houston and Atlanta areas, but will likely be extended nation-wide if successful. The FDIC has also announced a collaboration with Operation Hope to expand financial education for minority and/or women-owned businesses.

- The FDIC #GetBanked campaign should be seen a sister campaign to the national Bank On program.

**Treasury:** The Treasury Department appointed its first Counselor for Racial Equity in October 2021. The new Counselor, Janis Bowdler, will be expected to coordinate the Treasury's efforts to engage with diverse communities and to identify and mitigate barriers to accessing benefits and opportunities.

# Underbanked and basic access





**Central Bank Network for Indigenous Inclusion:** In October 2021, the Federal Reserve joined the Central Bank Network for Indigenous Inclusion. The move to join the network came as Governor Brainard highlighted the importance of addressing impediments Native communities face in accessing a range of financial services, including banking. In an October 2021 speech, Governor Brainard discussed the hope that joining the network will complement proposals in the September 2020 Advance Notice of Proposed Rulemaking to strengthen CRA regulations, specifically those that would allow banks to receive credit for eligible CRA activities in communities defined as “Indian Country”, even where there is not a branch nearby.

# Cannabis-related banking and marijuana legalization





## General outlook

- The direction of the federal regulatory and enforcement framework for financial institutions providing services to U.S. cannabis-related businesses has been unclear, with most banking organizations finding the provision of banking services to such businesses too perilous. FinCEN reported that as of June 30, 2021, there were only 706 financial institutions providing banking services to cannabis-related businesses.
- The growth of the cannabis sector has been accompanied by the emergence of new stakeholders, both in the sector and in regional and state markets. The unfolding of those stakeholder dynamics could influence the shape of cannabis legislation, its implementation and the implications for the financial sector.
- The **Cannabis Administration and Opportunity Act** (CAOA) represents the most prominent legislative proposal on cannabis reform and was released by Senate Majority Leader Schumer and Senators Booker and Wyden as a discussion draft on July 14, 2021. As proposed, this bill would, among other things:
  - Deschedule cannabis from the Controlled Substances Act (CSA) and transfer primary agency jurisdiction over cannabis from the Drug Enforcement Agency (DEA) to the Food and Drug Administration (FDA), the Treasury Department's Alcohol and Tobacco Tax and Trade Bureau (TTB) and the Justice Department's Bureau of Alcohol Tobacco Firearms and Explosives (ATF)
  - Recognize state law as controlling the possession, production, or distribution of cannabis
  - Require expungement of arrests and convictions for non-violent federal cannabis offenses
  - Establish 21 years of age as the minimum age required to purchase cannabis
  - Impose taxation of cannabis and establish social equity programs

# Cannabis-related banking and marijuana legalization





- The Sponsoring Offices of the CAOA requested public comment on the bill by September 1, 2021 before its formal introduction into Congress.
- Until a legislative fix is reached, the contradictions of the Federal government's cannabis policy continue to persist.
  - "Once comprehensive, the Federal Government's current approach is a half-in, half-out regime that simultaneously tolerates and forbids local use of marijuana. This contradictory and unstable state of affairs strains basic principles of federalism and conceals traps for the unwary."

    — *Justice Thomas, in a statement respecting petition for writ of certiorari for* *Standing Akimbo, LLC v. U.S.*
- Contrary to statements during the campaign for the 2020 election, the Biden Administration has not prioritized federal cannabis decriminalization or legalization.
- Although Democrats control the White House and both chambers of Congress, competing legislative priorities leave a narrow path for legalization before the 2022 midterm elections.

# Cannabis-related banking and marijuana legalization





**Legislative alternatives**

- Other legislative alternatives to cannabis reform include the following:
  - The **Secure and Fair Enforcement Banking Act** (SAFE Banking Act) would create protections for financial institutions to provide financial services to cannabis-related businesses that comply with state laws.
    - Following the House's vote to add the SAFE Banking Act to the National Defense Authorization Act (NDAA), Senator Booker reconfirmed his intent to block any legislation focused solely on cannabis-related banking, stating that the SAFE Banking Act "undermines the ability to get comprehensive marijuana reform and the kinds of things that are harder to get done like expungement of people's records."
    - Echoing Senator Booker's intent to block the SAFE Banking Act, Senate Majority Leader Schumer stated, "We certainly want the provisions, similar to the SAFE Banking Act, in our bill. But to get more moderate people . . . behind a comprehensive bill is the way to go. It's the right thing to do."
    - On December 7, 2021, the SAFE Banking Act was removed from the latest version of the NDAA.

# Cannabis-related banking and marijuana legalization





- The **Marijuana Opportunity Reinvestment and Expungement Act** (MORE Act) would deschedule cannabis on a nationwide basis while accomplishing social justice goals, some shared with the CAOA.
  - On September 30, 2021, the House Judiciary Committee approved the MORE Act, setting up a floor vote on the legislation.
- The **Strengthening the Tenth Amendment Through Entrusting States Act** (STATES Act) would amend the CSA to render inapplicable its prohibitions on cannabis-related conduct that complies with state law.
- The **States Reform Act** would deschedule cannabis and grant the FDA the same authority to regulate cannabis products that it has with respect to alcohol.
  - Introduced on November 15, 2021, the States Reform Act is the first comprehensive cannabis bill introduced by a Republican in Congress; however there is no indication that it has a significant chance of passing.

**Our visual memorandum analyzing the SAFE Banking Act, MORE Act and STATES Act is available here.**

# Federal Reserve regulatory updates





**General outlook**

- At an American Bar Association panel on January 6, 2022, Mark Van Der Weide, General Counsel of the Federal Reserve Board, stated that "Board staff is also hard at work on updates to our ancient regulations, such as regulations Y, K, H, O, and W. These regulations have not been refreshed in over 20 years..." The General Counsel went on to say that proposals would be forthcoming "on all five of these rules, I hope in the not too distant future." His statements give renewed hope that the long awaited modernization of some of the Federal Reserve's core banking regulations might happen this year.

**Regulation K**

- The Federal Reserve's General Counsel sees significant opportunities for the simplification and streamlining of Regulation K. Reform is expected to cover both the (1) permissible foreign activities of U.S. banking organizations and (2) permissible U.S. investments and activities of foreign banks.

**Project Gnosis**

Another priority, "Project Gnosis," seeks to move even more Federal Reserve legal interpretations into the public domain.

- In the last year, the Federal Reserve has published over 200 FAQs on various core regulations.
- Regulation K was mentioned as a regulation where there is significant interpretive gloss that should become more transparent.

# Capital and stress testing





**General outlook:** The U.S. banking agencies continue to give attention to bank capital requirements, including capital actions taken in response to the pandemic and the finalization of the implementation of Basel III.

- At a January 6, 2022 American Bar Association panel, Federal Reserve General Counsel Mark Van Der Weide stated:
  - "Implementing the Basel III End Game reforms remains the top priority for the Fed."
  - "We're also committed to putting these reforms in place in a way that's roughly capital-neutral for the U.S. banking system."
- No proposals for any of the components of finalizing the Basel III framework have yet been published by the agencies.

**Supplementary leverage ratio** (SLR): The Federal Reserve announced on March 19, 2021 that it would "soon" seek comment on measures to adjust the SLR, which would "not erode the overall strength of bank capital requirements." Related to that announcement, the temporary relief for banking organizations to exclude reserves held at the Federal Reserve and U.S. Treasury securities from total leverage exposure of the SLR expired on March 30, 2021.

- At the January 11, 2022 SBC hearing to consider Federal Reserve Chair Powell's nomination to serve another term as Chair, Powell stated, "We will return to [the SLR]. We want risk-based capital to be binding, not the leverage ratio. We do want to make adjustments … in ways that don't reduce the overall bindingness of the capital requirements on the largest firms."
- At the January 13, 2022 SBC hearing to consider Governor Brainard's nomination as Federal Reserve Vice Chair, Brainard argued, "I think it makes good sense to look for ways, while keeping capital strong, to find a way to adjust the [SLR] because of the much larger amount of reserves in the system."

# Capital and stress testing





- One option that the Federal Reserve could consider is a permanent exclusion from the SLR denominator for central bank reserves and potentially U.S. Treasury securities, along with adjusting the SLR minimum and buffer requirements.
  - A similar proposal has been floated by some, including Nellie Liang, now the Under Secretary for Domestic Finance at the Treasury Department.*
  - Then-Vice Chair for Supervision Quarles argued that excluding only reserves or both reserves and U.S. Treasuries would exacerbate funding preferences in the banking system. Instead, his preferred approach was to recalibrate the enhanced SLR (eSLR).

**Stress testing and capital planning:** Following the expiration of the Federal Reserve's temporary supervisory limitations on dividends and share repurchases due to the pandemic, large firms remain subject to the normal restrictions imposed by the regulatory framework, including the stress capital buffer. Changes to stress testing and capital planning requirements might include:

- More severe stress scenarios, which could have the effect of increasing firms' stress capital buffers
- Possible return of the formal qualitative objection to capital plans, although capital planning is a component of the supervisory LFI rating system

* Nellie Liang & Patrick Parkinson, *Enhancing the Liquidity of U.S. Treasury Markets Under Stress*, Brookings Institute (Dec. 16, 2020)

# Capital and stress testing





**Tailoring:** Both HFSC Chairwoman Waters and SBC Chairman Brown have expressed support for changes to the application of the SLR, LCR and NSFR requirements and reinstating the CCAR qualitative objection, all of which would require amendments to the relevant final rules.

- While legislative change is unlikely, Chairwoman Waters and Chairman Brown may pressure the U.S. banking agencies to amend the regulatory thresholds and criteria for application of certain prudential requirements above the statutory thresholds.

**G-SIB requirements:** Changes to the regulations applicable to G-SIBs could include:

- Adjustments to the factors underlying G-SIB surcharge scores, including further emphasis on the short-term wholesale funding factor and the possibility of a more graduated surcharge structure (i.e., reducing cliff effects)
- Increased external TLAC requirements
- New internal TLAC requirements

# Capital and stress testing





**Other initiatives:** There are a number of pending rulemaking initiatives on the banking agencies' agenda, including:

- Finalization of the implementation of Basel III, including significant amendments to the market risk capital rule (Fundamental Review of the Trading Book (FRTB))
  - On May 25, 2021, then-Federal Reserve Vice Chair for Supervision Quarles said that "tailoring the regulatory framework will remain a principle that we have in mind as we come out with proposals to implement the final pieces of Basel III."
  - In his December 2, 2021 speech, Quarles commented that implementation of the Basel III reforms should require policymakers to "determine whether adjustments to other parts of the capital framework are necessary to ensure that we do not unduly increase the level of required capital in the system."
  - The Fall 2021 Unified Regulatory Agenda suggests that the federal banking agencies expect to propose rules implementing the FRTB and the finalization of Basel III by the end of Q1 2022. In each previous agenda that this rule appears, the agencies missed their self-imposed target.
    - This is the sixth time this notice of proposed rulemaking has appeared on the short-term agenda of one or more of the agencies, going back to Spring 2019.

# Capital and stress testing





- Potential deployment of the countercyclical capital buffer (CCyB) in business-as-usual times as a potential tool for stimulating lending by reducing its calibration in stressed conditions
  - On June 3, 2021, then-Federal Reserve Vice Chair for Supervision Quarles stated, “The Federal Reserve should only turn on the CCyB in times of significant irrational exuberance; for example, in the face of a self-reinforcing cycle of borrowing and asset prices of the kind we saw in 2004–06. Yet, in my view, our through-the-cycle capital levels...in the United States have been set so high, that our CCyB is effectively already ‘on.’”
  - On March 1, 2021, Federal Reserve Governor Brainard stated a different view: “Over a longer horizon, changes in the economic environment associated with low equilibrium interest rates, persistently below-target trend inflation and low sensitivity of inflation to resource utilization could be expected to contribute to a low-for-long interest rate environment and reach-for-yield behavior. In these kinds of environments, it is valuable to deploy macroprudential tools, such as the countercyclical capital buffer, to mitigate potential increases in financial imbalances.”

# Capital and stress testing





- Potential changes to capital requirements related to climate change initiatives
  - Refer to the Winter Forecast Edition of our client update on Climate Regulatory Reform and the U.S. Financial Services Sector for more information on climate change initiatives, including potential changes related to prudential capital requirements.
- Finalization of risk-based capital requirements for depository institution holding companies that are significantly engaged in insurance activities
  - The proposed rule was issued in 2019. The Fall 2021 Unified Regulatory Agenda suggests that the Federal Reserve expects further action in the near term. In each previous agenda that this rule appears, further actions were expected by the end of the corresponding half-year period, and in each previous case, the agencies missed their self-imposed target. This is the fourth time this final rulemaking has appeared on the short-term rulemaking agenda, going back to Spring 2020.
- Refinement, finalization and implementation prudential capital and liquidity treatment of cryptoasset exposures
  - In November 2021, the Federal Reserve, FDIC and OCC issued a joint statement on crypto-asset “policy sprints,” which stated they “will evaluate the application of bank capital and liquidity standards to cryptoassets for activities involving U.S. banking organizations” and continue their engagement with the Basel Committee.

# Capital and stress testing

- The Basel Committee published a preliminary proposal for the prudential treatment of cryptoasset exposures of banks and other institutions subject to the Basel capital framework in June 2021.
  - The consultation:
    - Set out guiding principles for the prudential treatment of cryptoasset exposures
    - Proposed a classification system for categories of cryptoassets for purposes of the prudential framework
    - Proposed capital and liquidity requirements and supervisory expectations for banks that engage in cryptoasset activities
  - As proposed, the consultation would impose significant responsibilities on banks for assessing and monitoring the appropriate classification of cryptoasset exposures and, while generally applying elements of the existing Basel capital framework, would adopt a conservative approach to the proposed capital and liquidity requirements applicable to these exposures.
  - **Our visual memorandum analyzing the Basel Committee's consultation is available here.**

# Securities market structure





**General outlook:** Regulatory change to securities market structure and practices is a high priority for the SEC under Chair Gensler and the Treasury under Secretary Yellen, especially for retail public equity trading and U.S. Treasury markets.

**Gamification:** In August 2021, the SEC issued a request for comment on "digital engagement practices" by broker-dealers and investment advisers, such as gamification of trading, and the use of technology such as artificial intelligence and machine learning.

**Our client update, "*It's all fun and games: SEC requests information on digital engagement practices*," is available here.**

**Equity market reforms:** In light of the significant uptick in stock trading by retail investors in 2020 and 2021, particularly in meme stocks, SEC Chair Gensler has expressed concerns over broker-dealers' compliance with their best execution obligations and concentration of order flow within a small number of market makers, particularly given current payment for order flow practices and off-exchange equity trading.

- Chair Gensler has stated that he has asked SEC staff to consider whether the current equity market structure best promotes efficiency and competition and has indicated that rulemaking in this area would be on the horizon.

# Securities market structure





- Potential rulemaking could involve further SEC rules or guidance on payment for order flow, best execution, and how the national best bid and offer is calculated.
- In a hearing before the HFSC in October 2021, Chair Gensler raised concerns that brokers receiving payment for order flow potentially have a conflict of interest because they fill the order without competition from the rest of the market. He suggested that more transparency in this process could help achieve best execution.

**Settlement cycle**

- In December 2021, SIFMA, ICI, DTCC and Deloitte released a report recommending that the industry move toward a T+1 settlement cycle by the first half of 2024. The report summarizes the work of industry groups to date and makes specific recommendations required to be undertaken by the financial services industry to accelerate the settlement cycle to T+1.

# Securities market structure





**Treasury market reforms:** In March 2020, the onset of the COVID-19 pandemic triggered a significant pricing disruption in the U.S. Treasury market as many investors sought to liquidate holdings of Treasuries faster than Treasury dealers were willing and able to accommodate.

- Several potential Treasury market reforms have been suggested by market participants, including the G30 (our public memo on the relevant July 2021 G30 report is available **here**). These include:
  - A standing repo facility that could provide backstop repurchases during periods of stress
  - Increased central clearing in Treasury cash and repo markets
  - Modifications to the supplementary leverage ratio calculation to avoid discouraging banks from providing liquidity in Treasury markets
  - SEC review of prudential safeguards at broker-dealers in U.S. Treasury securities and Treasury repos that are not affiliated with banks
  - Expansion of the TRACE reporting system to capture all transactions in U.S. Treasury securities and Treasury repos
  - Application of SEC Regulations ATS and SCI to all significant trading platforms for Treasury securities
  - An interagency study and reconsideration of all exemptions of Treasury securities from U.S. securities laws

# Securities market structure





- Reform of the Treasury markets is also an area of focus in the academy, including this article forthcoming in the Columbia Law Review and this Vanderbilt Law Research Paper.
- In November 2021, the Inter-agency Working Group on Treasury Market Surveillance, consisting of staff from the U.S. Department of Treasury, Federal Reserve Board, Federal Reserve Bank of NY, SEC and CFTC, released a report outlining key principles to guide policymakers in their efforts to reform the Treasury market and summarizing their progress toward evaluating potential reforms.
  - Although the report does not endorse any specific policy proposals for reforming the Treasury market, the principles discussed in the report are consistent with the objective's of the July 2021 G30 report on Treasury Market reform, as well as recent proposals offered by other policymakers, including the SEC and DTCC.
- At the IAWG annual U.S. Treasury Market Conference, Chair Gensler announced that he has asked SEC staff to make recommendations for rulemaking, including (1) requiring principal trading firms to register as dealers, (2) requiring Treasury trading platforms to register with the SEC, (3) expanding central clearing in cash and repo Treasury markets and (4) increasing resiliency for open-end funds and money market funds, including enhanced reporting and disclosure through Form PF.

# Securities market structure

- On January 26, 2022, the SEC proposed new rules that would no longer exempt Treasury trading platforms from Regulation ATS. The proposal will be discussed in further detail in a forthcoming client update.
- In addition, the proposed rules would generally expand the scope of systems that are within the definition of "exchange," and therefore must either register or operate as an ATS, to include various broker-dealer operated communication systems that receive indications of users' interest to trade, but do not execute orders.

– At a January 6, 2022 American Bar Association panel, Federal Reserve General Counsel Mark Van Der Weide stated that the Federal Reserve is also working with the PWG, FSOC and international regulators to address structural infirmities in the financial system involving non-bank financial firms and Treasury markets.

– The DTCC's Fixed Income Clearing Corporation (FICC) released a White Paper in October 2021 advocating that regulators and market participants adopt FICC's open access approach to central clearing of Treasury securities. FICC claims that its model is better than the singular approach used by the cleared swaps market because open access allows market participants that provide critical liquidity to the U.S. Treasury markets to access clearing.

# Reforms to short-term funding markets





**SEC proposed reforms:** In December 2021, the SEC published a proposed rule to improve the resilience and transparency of money market funds (MMFs). The key reforms proposed by the SEC include the following:

- Requiring institutional prime and institutional tax-exempt MMFs to adopt "swing pricing" policies, which would require the adjustment of the fund's net asset value (NAV) per share when the fund has net redemptions – see next slide for discussion of mechanics
- Increasing required daily liquid asset requirements to 25% (from 10% currently) and weekly liquid asset requirements to 50% (from 30% currently)
- Eliminating provisions of Rule 2a-7 that currently allow MMFs to impose liquidity fees or to impose gates to temporarily suspend redemptions
- Enhancing certain reporting requirements to improve the SEC's ability to monitor and analyze money market fund data

If adopted, the swing pricing requirement would become effective 12 months after the effective date of a final rule, and the increased liquidity requirements would become effective six months after the effective date of a final rule.

# Reforms to short-term funding markets





**Swing pricing mechanism in SEC proposed rule:** An institutional prime or institutional tax-exempt MMF subject to the SEC's proposed swing pricing mechanism would follow these steps to determine its **swing factor** – i.e., the amount as a percentage of the fund's NAV by which the MMF would be required to adjust its NAV per share:

- Determine if the fund has net redemptions over a pricing period. If no net redemptions over the pricing period, no swing factor needs to be applied.
- Assuming the fund has net redemptions over the pricing period, determine the swing factor by making a good faith estimate, supported by data, of the costs the fund would incur if it sold a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions over the pricing period. The good faith estimate must include, for each security in the fund's portfolio:
  - Spread costs (i.e., valuing the security at its bid price);
  - Brokerage commissions, custody fees and any other charges, fees and taxes associated with portfolio security sales

# Reforms to short-term funding markets





- Only if net redemptions over the pricing period exceed the **market impact threshold**, market impacts
  - As proposed, market impact threshold means an amount of net redemptions for a pricing period that equals the value of **four percent** of the fund's NAV divided by the number of pricing periods the fund has in a business day
  - To estimate market impacts, an MMF would first estimate the percentage decline in the value of the security if it were sold, per dollar of the amount of the security that would be sold, under current market conditions (market impact factor). Then, the MMF would multiply the market impact factor by the dollar amount of the security that would be sold if the fund sold a pro rata amount of each security in its portfolio to meet the net redemptions for the pricing period

Under the proposal, there would be **no upper limit** on an MMF's swing factor.

The SEC's swing pricing requirement is likely to be a key focus of commenters on the proposal, including in relation to the operational complexities that such a requirement would introduce.

- In the preamble to the proposal, the SEC "acknowledge[d] that swing pricing will introduce new operational complexity" for institutional MMFs, but stated that to the extent that operational changes are necessary to meet the requirements of the proposal, such changes "are warranted to address investor harm and dilution that occurs when redeeming investors reduce the fund's liquidity and impose other costs on remaining investors."

# Reforms to short-term funding markets





**Other approaches to reform:** The SEC's reform proposals come in the context of a global effort to assess which reforms to MMFs are necessary in order to address vulnerabilities demonstrated by the COVID-19 shock, which made clear that post-2008 reforms to MMFs had not fully achieved their aims.

- In the United States for example, the President's Working Group on Financial Markets in December 2020 released a report (PWG Report) offering several MMF reform ideas, several of which are consistent with those proposed by the SEC in December 2021.
  - The PWG Report also included other potential reforms, such as capital buffer requirements, minimum balance at risk rules and sponsor support requirements. The SEC discussed the potential benefits and drawbacks of these and other reform ideas in the preamble to its proposal but ultimately declined to include them as part of the proposed rule.
- The FSOC is expected to discuss MMFs at its upcoming meeting in February 2022.
- Internationally, in June 2021 the FSB released a consultation report on policy options to enhance MMF resilience and in October 2021 issued a final report with no material changes to the policy options included in the June consultation, which were generally consistent with the PWG Report.
  - The FSB report does not impose any new regulatory requirements on MMFs. Instead, as the SEC intends to do in the United States, regulators in each country must decide which, if any, policy approach they will implement.

# BSA/AML





**General outlook:** Regulatory change to the Bank Secrecy Act (BSA)/anti-money laundering (AML) regime remains a high priority.

**Leadership:** Brian Nelson was confirmed as Under Secretary of the Treasury for Terrorism and Financial Intelligence on December 2, 2021; Himamauli "Him" Das is Acting Director of FinCEN.

**Legislative and regulatory changes:** The **Anti-Money Laundering Act of 2020** (AMLA) is the most important BSA/AML legislation in years and could have a significant impact on AML compliance and supervision once it is fully implemented. FinCEN is also moving forward with a number of other rulemakings to address gaps in and modernize the U.S. AML regime.

- Key AMLA rulemakings are now under way, though the process will take some time to complete.
- Enhanced AML regulations are a component of President Biden's U.S. Strategy for Countering Corruption.

**Our visual memorandum on AMLA is available here.**

**Our client update on the U.S. Corruption Strategy is available here.**

# BSA/AML





## AMLA implementation

**Beneficial Ownership Registry**: On December 7, 2021, FinCEN published an NPR regarding requirements for certain legal entities to submit their beneficial ownership and company applicant information to the agency. The proposed rule is the first of three rules to implement the beneficial ownership reporting provisions of the Corporate Transparency Act (CTA), which is part of the AMLA. Comments are due by February 7, 2022.

**Our client update on the beneficial ownership proposed rule is available here.**

**AML priorities:** FinCEN released the first national priorities for AML/CFT policy (the Priorities) on June 30, 2021 but has not yet issued proposed implementing regulations. Banks are not currently required to incorporate the Priorities into their risk-based BSA compliance programs, but should start considering how they will incorporate the Priorities into their risk-based BSA compliance programs, per guidance in the interagency statement released with the announcement of the Priorities.

**No-Action letter process:** On June 30, 2021, FinCEN also issued a report (the No-Action Report) concluding that it should establish a no-action letter process to respond to inquiries concerning the application of the BSA and other AML laws and regulations to specific conduct. The independent authority of other Federal functional regulators to enforce the BSA may limit the usefulness of no-action letters issued by FinCEN.

**Our client update on the Priorities and the No-Action Report is available here.**

# BSA/AML





## AMLA implementation

**Suspicious Activity Report (SAR) Sharing Pilot Program:** On January 24, 2022, FinCEN released a Notice of Proposed Rulemaking that would establish a limited-duration pilot program, permitting participant financial institutions to share SARs with their foreign branches, subsidiaries and affiliates. To participate in the pilot program, financial institutions will be required to submit a written application for admission to FinCEN, and participation would include additional confidentiality, information-security, internal control, reporting and recordkeeping requirements.

FinCEN has invited public comment on questions related to the establishment of the pilot program, such as expected costs and benefits, technical challenges, the merits of quarterly reporting requirements and how to protect SAR confidentiality. The comment period closes on March 28, 2022.

**Our client update on the SAR sharing pilot program proposed rule is available here.**

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# BSA/AML





## Other regulatory initiatives

**Expanding BSA/AML requirements to fight corruption:** President Biden's U.S. Strategy for Countering Corruption (the Strategy) identified gaps in AML regulations as potentially facilitating corrupt activity and forecasts additional regulation and reporting requirements.

- The Strategy provides that Treasury will re-examine its 2015 NPR that would prescribe minimum standards for anti-money laundering programs and suspicious activity reporting requirements for certain investment advisors.
- On December 6, 2021, FinCEN issued an ANPR regarding the expansion of reporting requirements for real estate transactions.

**AML modernization:** On December 14, 2021, FinCEN issued a request for information (RFI) seeking comments on ways to streamline, modernize and update the BSA/AML regime. The RFI is part of FinCEN's review of BSA regulations and related guidance, as required by AMLA. FinCEN will report to Congress the findings of the review, including administrative and legislative recommendations. Responses to the RFI are due by February 14, 2022.

**Our client update on the AML modernization RFI is available here.**

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# BSA/AML





## Enforcement

**AML supervision and enforcement:** AML is likely to continue to be a high priority for the financial regulators and, while overall enforcement numbers have been down in recent years, regulators, especially the New York State Department of Financial Services, will not hesitate to use their enforcement powers in cases involving serious AML program breakdowns.

**Ransomware advisory for financial institutions:** On November 12, 2021, FinCEN updated and replaced its Advisory on Ransomware and the Use of the Financial System to Facilitate Ransom Payments (the Advisory). The Advisory notes that FinCEN has now designated ransomware attacks as "situations involving violations that require immediate attention," which imposes heightened reporting requirements on financial institutions. **Our client update on the Advisory is available here.**

**Greater scrutiny of fintechs/crypto:** Greater regulatory scrutiny for AML compliance is expected for Fintechs (especially payments-related) and crypto firms as they assume an increasingly important role in financial services.

- On October 28, 2021, the Financial Action Task Force (FATF) released an updated version of its guidance on the application of its recommendations to virtual assets and virtual asset service providers (VASPs). The guidance includes recommendations related to stablecoins, non-fungible tokens and decentralized finance.

**Our client update on FATF's updated guidance is available here.**

# Community Reinvestment Act





**Another shot at harmonizing**

- The Federal Reserve, FDIC and OCC issued an interagency statement stating that they are committed to working together to jointly strengthen and modernize regulations implementing the CRA.

**Building on Federal Reserve proposal**

- Acting Comptroller Hsu stated that any joint rulemaking should build on the Federal Reserve's September 2020 proposal, which addresses some of the main criticisms of the now rescinded OCC rule related to CRA scoring, data collection and assessment areas.
  - *CRA scoring*: The Federal Reserve proposal would score retail lending and community development performance separately, while the rescinded OCC rule used a single metric.
  - *Data collection*: The Federal Reserve's proposed metrics would rely on existing data while the rescinded OCC rule required banks to submit new compliance data.
  - *Assessment areas*: The Federal Reserve proposal requested feedback on a number of different assessment area options, but is skeptical that the deposit-based assessment areas for certain institutions as structured in the rescinded OCC rule would adequately address the reinvestment needs of affected communities.

**Timing**

- In the Fall 2021 Unified Regulatory Agenda, the Federal Reserve, OCC and FDIC all state that the agencies are jointly developing a proposed rule to modernize the regulations implementing the CRA.

# Competition





## Competition Order

President Biden issued an executive order on Competition on July 9, 2021 (the Competition Order) as part of his administration's intention to "address overconcentration, monopolization and unfair competition in the American economy." With respect to banking and consumer finance, the Competition Order:

- Encourages the Attorney General, in consultation with the Chairman of the Federal Reserve, the Chairperson of the FDIC and the Comptroller of the Currency, to adopt a plan for the revitalization of merger oversight under the Bank Merger Act and BHC Act.
  - The Competition Order encouraged this action to be taken by January 5, 2022. This date has now come and gone without coordinated action by the DOJ and the banking regulators, although as discussed on the next page the DOJ's Antitrust Division has issued a renewed request for comment on its approach to reviewing the competitive factors of bank mergers.
- Directs the Secretary of the Treasury, by April 5, 2022, to submit a report assessing the effects on competition of large technology firms' and other non-bank companies' entry into consumer finance markets.
- Encourages the CFPB to consider:
  - Commencing or continuing a rulemaking under section 1033 of the Dodd-Frank Act to facilitate the portability of consumer financial transaction data so consumers can more easily switch financial institutions and use new, innovative financial products
  - Using its UDAAP authority to ensure that actors engaged in unlawful activities do not distort the proper functioning of the competitive process or obtain an unfair advantage over competitors who follow the law

# Competition





- References the “pro-competition” jurisdiction and objectives of the CFPB and directs the Chair of the White House Competition Council to invite the Director of the CFPB to participate in the Council to the extent consistent with the CFPB’s statutory authorities and obligations.
- **Our client update on the Competition Order is available here.**

**DOJ bank merger guidelines**

On December 17, 2021 the DOJ’s Antitrust Division announced that it will seek additional public comments on whether and how it should revise its Bank Merger Competitive Review Guidelines (the Banking Guidelines), which were last updated in 1995.

- The Antitrust Division had previously in September 2020 requested comment on the Banking Guidelines.
- The updated request for comment notes that several comments received in response to the September 2020 “expressed support for broadening the factors considered by the Division when evaluating bank mergers,” and therefore the updated request “focuses on whether bank merger review is currently sufficient to prevent harmful mergers and whether it accounts for the full range of competitive factors appropriate under the laws.”
- The DOJ characterized its updated request for comment as “part of an ongoing effort by the federal agencies responsible for banking regulation and supervision,” and committed to continuing to consult with the Federal Reserve, OCC and FDIC.

# Competition





**FDIC Board members' joint statement:** On December 9, 2021, two FDIC Board members, Director Gruenberg and CFPB Director Chopra, issued a joint statement on the CFPB website announcing that the FDIC Board had approved a "Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions." The joint statement described the content of the request for information and expressed strong support for the request.

- The request would seek public input on the FDIC's approach to considering prudential factors in acting on a bank merger application, specifically asking "whether bright line minimum standards for prudential factors should be established, and if so, what minimum standards for which prudential factors."
- The request for information has not yet been published in the Federal Register.

**CFPB focus:** On January 26, 2022, the CFPB issued an RFI about fees on bank accounts, credit cards and other financial products with an intention to ""strengthen competition in consumer finance." For further information on this RFI, see the Consumer financial protection section on slides 6 and 7.

# FDIC remote exams





**Overview:** The digital era practice of partly remote examinations was accelerated by the COVID-19 pandemic, which required regulators to adjust to an entirely remote environment. Regulators are looking to the lessons learned from nearly two years of remote exams to help shape their future approach. The FDIC began its retrospection with an RFI in August 2021, and we can expect other regulators to either follow or track closely the answer to the FDIC's RFI. The comment period closed in mid-October 2021.

**FDIC:** The FDIC's RFI asked state non-member banks to respond to questions about the FDIC's supervisory approach to examinations during the pandemic, including on-site and off-site activities, use of technology and communication methods.

- Some of the considerations between on-site and remote examinations include the examiners' ability to access real-time information off-site, reductions in the travel commitments and time that examination teams spend on-site, the bank's ability to develop relationships and communicate with examiners without face-to-face interactions, and technological difficulties in sharing data and exam files digitally.
- We believe that some type of hybrid model, with tailoring depending upon the size and complexity of the bank is a likely path forward.

# Regulation Best Interest and its variants





**Regulation Best Interest:** The SEC adopted Reg BI in June 2019, requiring broker-dealers and their associated persons, when making a recommendation to a retail customer, to act in the best interest of the retail customer at the time the recommendation is made.

- Compliance was required by June 2020 and included additional obligations relating to disclosure, a standard of care, conflicts of interest, policies and procedures.
- The SEC has so far adopted a measured approach to implementation and enforcement of Reg BI. Initial examinations have focused on "assessing whether firms have made a good faith effort to implement policies and procedures reasonably designed to comply" with Reg BI.
- In public statements, SEC Chair Gensler and senior advisors have indicated the SEC intends to take a stronger approach, and a significant increase in Reg BI enforcement is expected in 2022.

**State law analogues.** 23 states, by one count, as of July 2021 have proposed or adopted best interest requirements or standards of fiduciary conduct that are similar to Reg BI, and potentially more stringent.

# Regulation Best Interest and its variants





**DOL fiduciary rule.** The Biden Administration will begin a new chapter in the long and tortuous history of the DOL fiduciary rule. After the Fifth Circuit had vacated an earlier, Obama-era version of the fiduciary rule in 2018, the Trump-era DOL in June 2020 proposed and in December 2020 finalized a more industry-friendly version of the rule, which took effect in February 2021.

- The now-effective DOL fiduciary rule reinstates the five-part test for defining an investment advice fiduciary that had previously been in effect since 1975, which many regard as impeding DOL enforcement due to its complexity.
- The DOL concurrently adopted a new exemption for certain categories of conflicted investment advice while also clarifying that fiduciary requirements may apply to recommendations to roll assets out of an ERISA-protected plan into an IRA.
- Though some were surprised that the incoming Biden Administration did not prevent the 2020 rule from taking effect, the DOL under new leadership in April 2021 announced its intent to amend or revoke many of the Trump-era changes through notice-and-comment rulemaking.

# Bank charters





**General outlook:** The digital transformation and fintech competition can be expected to intensify, which will lead to a continued focus on obtaining both traditional and innovative bank charters. That said, we expect increased scrutiny of efforts to obtain bank charters through both M&A activity and de novo charter applications under the Biden Administration to continue.

- Fintechs seeking to obtain a bank charter are pursuing various approaches, influenced by their business priorities.
  - The benefits of a bank charter include direct access to the payment system, the ability to use insured deposits as a low-cost source of funds, the ability to export interest rates, exemption from or preemption of state licensing requirements and, for national banks, federal preemption of state lending laws.
  - Certain bank charter options avoid causing the bank's parent company and the parent company's controlling shareholders to be subject to the Bank Holding Company Act, but these options have their own drawbacks.
  - The broader trend of fintechs expanding into traditional banking services is expected to increase competitive pressures on traditional banks over time.

# Bank charters





**OCC charters and the regulatory perimeter**

- Receptiveness to non-traditional bank charter applications has decreased during the Biden Administration.
  - Acting Comptroller Hsu recently concluded a review of all pending chartering decisions and interpretative letters. In a November 3, 2021 speech Hsu said the results of this review will align with his vision for “a holistic strategy regarding the bank regulatory perimeter.” A key element of this vision appears to be a focus on “synthetic banking providers” that offer banking services outside the regulatory perimeter; Hsu has called for agencies to coordinate and modernize their regulatory response.
  - Mark Van Der Weide, General Counsel of the Federal Reserve Board, has echoed this concern, stating in an American Bar Association panel on January 6, 2022 that the Federal Reserve is “watching with some level of concern, the emergence of a wide variety of special-purpose bank charters, and the broader build-up of substantial outside-in pressures on the regulatory perimeter.”
  - The Biden Administration is expected to release an executive order on digital assets that would focus on increasing coordination among federal regulators in policing the regulatory perimeter.

# Bank charters





## OCC charters and the regulatory perimeter

- On November 23, 2021 the OCC issued Interpretive Letter #1179 regarding a national bank's authority to engage in certain cryptocurrency activities and the ability of the OCC to charter limited-purpose national trust banks.
  - We believe the OCC's actions effectively draw a line in the sand that is designed to slow the expansion of cryptocurrency activities within national banks while the OCC and other agencies work to determine the broader framework they intend to apply to these activities likely beginning sometime in 2022 and consistent with the interagency "crypto sprint" statement. See the Winter Forecast Edition of our client update on U.S. Digital Asset Regulatory Reform for additional information on the OCC's approach toward crypto activities and how Interpretive Letter #1179 creates an uneven playing field among banks.
- The OCC's desire to restrain national banks' entry into crypto is evident in a conditional approval issued in January 2022, which states expressly that the bank "shall not engage in any crypto-asset activities or services currently performed by [its parent company]" or otherwise, without a prior written determination of no supervisory objection from the OCC.
  - This restriction would apply to the bank and its operating subsidiaries, but not its parent or sister companies, with respect to which the Federal Reserve is responsible for determining the permissibility of crypto activities.
  - Although there are strong arguments that many crypto activities should be permissible for financial holding companies under the Bank Holding Company Act, the Federal Reserve has yet to publish any guidance addressing this issue.

# Bank charters





- **Stablecoin issuers:** On November 1, 2021, the President's Working Group on Financial Markets released its anticipated report on stablecoins, recommending that all stablecoin issuers should be required to be insured depository institutions (the PWG Report). If Congress takes up the PWG Report's recommendation, that could result in an increase in traditional charter applications.
  - As described in our client update, a puzzling result of the PWG Report is that it recommends a regulatory framework that would effectively require stablecoin issuers to invest in riskier assets and rely on FDIC insurance rather than permitting stablecoins backed by a 100% cash and cash equivalent reserve.
  - In a January 13, 2022 speech, Acting Comptroller Hsu echoed the PWG Report's recommendation that stablecoin issuers should be regulated as banks, arguing that such regulation could prevent runs and "enable *more* innovation in crypto and make those innovations more durable" (emphasis in original).
  - For additional information on the regulation of digital assets, see the Winter Forecast Edition of our client update on U.S. Digital Asset Regulatory Reform.
- **Fintech charter:** Despite the OCC's June 2021 court victory against the NYDFS on procedural grounds, the fintech charter is likely to stay bogged down in court cases for a long time. At stake is whether the emerging fast and real-time payments systems will be subject to 50 different state regulators or a national regulator at the federal level.

# Bank charters





**ILCs and other state charters**

- The FDIC's approval of applications for federal deposit insurance by two de novo ILCs in 2020 suggested that an ILC charter could be one option for fintechs. That said, there have been no new ILC approvals since the Biden Administration's appointees have resulted in a Democratic majority on the FDIC Board.
  - In January 2021, Japanese e-commerce and financial technology company Rakuten filed its third application for FDIC deposit insurance for a de novo ILC.
  - Political risk is an issue for ILC charters, as reflected by bills that propose to (1) impose a new 3-year moratorium on regulatory approval of deposit insurance for de novo ILCs and certain changes of control of existing ILCs and (2) remove the ILC exemption from the definition of "bank" in the BHC Act.
- We expect novel digital currency-oriented state bank charters such as the Wyoming special purpose depository institution charter and the Nebraska digital asset depository institution charter to continue to grow in number, but such charters may come under pressure from the SEC or prudential banking agencies.
- We similarly expect state legislation such as North Carolina's regulatory sandbox bill, which provides a waiver from licensing and other compliance requirements on a temporary basis, to reinforce the trend of fintechs expanding into traditional banking services.

# Open banking and data access





**Potential expansion of open banking**

- In October 2020, the CFPB issued an ANPR soliciting public comments on how to implement Section 1033 of the Dodd-Frank Act, which provides for consumer rights to access financial records. This ANPR remains on the CFPB's rule list for the Fall 2021 Unified Regulatory Agenda, which states that the CFPB is reviewing comments and assessing next steps.
- The CFPB ANPR recognizes the following:
  - The providers of consumer financial products and services generally accumulate data about consumers and their use of those products and services.
  - Consumer access to these data allow consumers to manage their financial accounts and can enhance consumers' control of their financial matters.
  - While consumer access to financial records can enable the development of innovative and beneficial consumer financial products, it can also present consumer risks.
- The Competition Order states that the Director of the CFPB is encouraged to consider commencing or continuing a rulemaking under Section 1033 to facilitate the portability of consumer financial transaction data so consumers can more easily switch financial institutions and use new, innovative financial products.

# Open banking and data access





- Both banks and the fintechs they compete with are unhappy with the status quo.
  - Banks have long objected to screen scraping, and in response to consumer demand, many have entered into agreements with fintechs such as Plaid to share data through APIs. Such partnerships, nonetheless, can be burdensome from a third-party risk management perspective.
  - Plaid and other fintechs engaged in data aggregation are in favor of becoming regulated and supervised by the CFPB, arguing the benefits of stronger access rights for consumers and better oversight and assurances for the authorized data ecosystem.
  - For Plaid's perspective on why additional CFPB regulation is needed, see Plaid's February 5, 2021 comment letter on the CFPB's ANPR, available here.
- On October 21, 2021, several technology companies received orders from the CFPB to provide the agency with information regarding their payments products.
  - Director Chopra issued a statement alongside the orders noting that the information collection effort will "yield insights that may help the CFPB to implement other statutory responsibilities, including any potential rulemaking under Section 1033," the provision of Dodd-Frank that provides for consumer rights to access financial records.

# Bank partnerships with fintechs





**Risk management of third-party relationships**

- We expect the trend of increasing supervisory focus on bank/fintech partnerships to continue.
  - Acting Comptroller Michael Hsu stated in a November 16, 2021 speech that “modernizing the bank regulatory perimeter . . . [will] likely require determining what is acceptable in a bank-fintech relationship.” He also repeated a warning from his prior speech delivered on November 3, 2021, that bank/fintech partnerships are regarded by some as “‘rent-a-charter’ arrangements, which allow fintechs to skirt a host of rules at the expense of customer protection and bank safety and soundness.” See slides 65 and 66 for information on true lender issues.
  - Mark Van Der Weide, General Counsel of the Federal Reserve Board, stated in an American Bar Association panel on January 6, 2022 that “we're carefully assessing partnerships between banks and FinTech firms, with an emphasis on ensuring that the bank partners do sufficient due diligence on their FinTech partner, that the bank partners have sufficient control of the relationship, and that the partnerships don't create outsized risks to the bank.”

# Bank partnerships with fintechs





**Risk management of third-party relationships**

- On July 13, 2021, the Federal Reserve, FDIC and OCC proposed interagency guidance on how banking organizations should manage the risk associated with their third-party relationships. **Our client memorandum analyzing the proposal is available here.** The deadline for comments was October 18, 2021.
  - Practically speaking, banking organizations with mature compliance and third-party risk management processes and policies would likely need to make relatively minimal updates to their third-party risk management frameworks.
  - The proposal may represent a more meaningful change for smaller institutions currently subject to existing Federal Reserve or FDIC guidance, which is generally less prescriptive and detailed than the proposal and the existing OCC guidance on which it is based.
- On November 18, 2021, the Federal Reserve, FDIC and OCC issued a final rule that requires certain bank service providers to notify affected banking organization customers of computer-security incidents. The compliance date for the final rule is May 1, 2022.
  - Fintechs that provide services covered under the Bank Service Company Act to banks would be subject to these cybersecurity notification obligations.
  - The rule suggests that federal banking regulators may be gearing up to impose additional affirmative compliance obligations on fintechs that partner with banks in the future.

# Federal Reserve master accounts





**General Outlook:** The Federal Reserve, which has substantial discretion in its decision-making process on access to Federal Reserve Bank accounts and services, continues to give attention to its approach for evaluating requests for master accounts and access to financial services by firms with non-traditional bank charters.

- In January 2022, on the subject of Federal Reserve master accounts for Wyoming special purpose depository institutions, Federal Reserve Chair Powell stated that "We are looking carefully at it, and I do think we'll make some progress on this," adding that the firms have made "good arguments" for having their own master accounts at the Federal Reserve.

**Proposal:** In May 2021, the Federal Reserve proposed guidelines for allowing access to accounts and payments services at Federal Reserve Banks in a push to provide clarity on when firms with non-traditional bank charters may access the Federal Reserve's master accounts and other associated services, though the guidelines reiterate the legal barriers preventing non-depository institutions, including many fintech payments companies, from opening master accounts. The comment period closed on June 12, 2021.

- The proposed guidelines are built around six principles, founded on an approach of risk management and mitigation.
- The first principle of the proposed guidelines reiterates section 19(b) of the Federal Reserve Act, which provides that only member banks or insured or uninsured depository institutions are eligible to open master accounts, as well as requiring Reserve Banks to consider a depository institution's compliance with the Bank Secrecy Act, AML and sanctions restrictions and other laws – effectively reiterating the bar on non-depository institution payments companies from gaining direct access to the Federal Reserve's payment systems.

# Federal Reserve master accounts





- The remaining principles relate to:
  - Safety and soundness of the banking system – i.e., credit, operational, settlement, cyber or other risks to the Reserve Bank
  - Potential risks to the payment system
  - U.S. financial stability
  - Prevention of financial crimes
  - Potential adverse effects on the Federal Reserve's ability to implement monetary policy

**Our May 2021 client update on Federal Reserve master accounts is available here.**

# Valid-when-made





**General outlook:** In mid-2020, the OCC and the FDIC issued final rules affirming a longstanding "valid-when-made" doctrine, which the 2nd Circuit's 2015 Madden decision did not address, thereby creating uncertainty about the enforceability of a loan's interest rate following the assignment of that loan to a non-bank. The ultimate fate of these rules now rest with the courts.

**OCC and FDIC valid-when-made final rules**

- **OCC rule** (June 2, 2020)—A loan that is legally originated by national banks and savings associations continues to be valid upon its transfer, sale, or other assignment, so that interest permissible under 12 U.S.C. § 85 or § 1468(g) before the transfer continues to be permissible after the transfer.
  - This rule is different from the OCC's true lender rule, which was invalidated under the Congressional Review Act, as discussed below on slides 65 and 66.
- **FDIC rule** (June 25, 2020)—Whether interest on a loan is permissible under § 27 of the FDIA is determined as of the date the loan was made and shall not be affected by the sale, assignment, or other transfer of the loan, in whole or in part.

For more on the topic, please refer to our white paper, *Federal Banking Regulators Can and Should Resolve* Madden *and True Lender Developments* (Aug. 14, 2018) and our follow-up client updates: "*The OCC Reaffirms the Valid-When-Made Doctrine*" (June 1, 2020).

# Valid-when-made





**Reactions and further developments**

- In July 2020, state AGs from CA, IL and NY filed a complaint challenging the final rules on the grounds, among others, that the procedures for preemption were not followed and that the rules were arbitrary, capricious and an abuse of discretion, creating a regulatory vacuum effectively exempting some market participants from state and federal oversight, and that the OCC rule, in particular, impermissibly seeks to expand National Bank Act preemption beyond national banks.
- In March 2021, the OCC filed a reply in support of its motion for summary judgment in the lawsuit filed by the state AGs.
  - The OCC argues that the challenged final rule is a reasonable interpretation of § 85 of the National Bank Act and should be upheld and that the AGs' opposition is "premised on the erroneous assumption that the [final rule] preempts state law and inappropriately extends § 85 to non-banks."
- Similarly, in May 2021, the FDIC filed a motion for summary judgment in the lawsuit filed by certain state AGs to rescind the rule, arguing the challenged final rule is a reasonable interpretation of § 27 of the FDIA, to which the AGs replied by filing their opposition in June 2021.
- Rulings have not yet been issued on these lawsuits brought by the state AGs against the OCC and the FDIC.
- In the midst of these ongoing legal battles brought by the state AGs, in April 2021, the MA District Court upheld the validity of the "valid when made" doctrine acknowledging its historical pedigree from the 19th century. *Robinson v. Nat'l Collegiate Student Loan Trust* 2006-2 (1:20-cv-10203).
- Acting Comptroller Hsu indicated that the OCC under his direction will not look to rescind the rule (June 2021).

# True lender





**Impact of the repeal of the True Lender Rule**

- The Congressional override of the True Lender Rule marks a return to a world in which true lender issues will be determined on a case-by-case basis, informed by differing state laws and the facts in each particular instance.
  - Certain states (e.g., Illinois and Maine) codified modified versions of the "predominant economic interest" test to determine the true lender subject to state licensing and usury requirements. See here for details.
- Creates uncertainty for investors, banks and marketplace lenders about the ability of loan purchasers to collect, as assignee of loans, the interest rates that had originally been agreed to.
  - In one pre-True Lender Rule instance, that uncertainty led to a state regulator filing a lawsuit against a marketplace lender that was resolved, after several years of litigation, by a settlement in which an out-of-state bank agreed (among other things) to cap the interest rates on all loans it made in the state. *See also*, a settlement between an online lender and the D.C. attorney general in November 2021 and a consent order issued by the California Department of Financial Protection and Innovation in December 2021.

# True lender

- The practical impact may be limited in today's low interest rate environment but may become more important as interest rates rise. The prospect of federal legislation is unclear, but there have been various proposed bills that would create a federal usury limit but they still have a long way ahead in the legislation process. *See e.g.*, H.R.5050; S.2833; S.1659.