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THE BANKERS' BULLETIN

Regulatory & Enforcement Insights on Recent Bank Industry Developments

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About The Firm

Luse Gorman, PC is a Washington, D.C.-based law firm specializing in mergers, capital raising transactions, regulatory, enforcement, corporate, securities, employee benefits, executive compensation, and tax law for regional and community banks across the United States. Our attorneys have served with the major federal banking and securities agencies, and regularly engage with regulators on a range of novel and complex legal issues.

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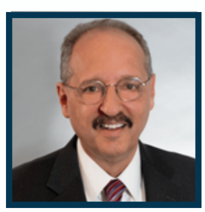

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Please reach out to any of our regulatory and enforcement attorneys above, or to your primary Luse Gorman contact, if you have any questions related to the topics covered in this edition of *The Bankers' Bulletin.*

OCC Issues Cease & Desist Order Against Blue Ridge Bank

Summary. On Jan. 24, the OCC issued a cease and desist order (C&D) against Blue Ridge Bank, N.A. for an alleged failure to correct previously reported problems, deficiencies in the Bank's BSA/AML compliance program, and violations of BSA/AML regulations. The wide-ranging C&D replaces a prior formal agreement (FA) with the agency that was less than eighteen months old.

Takeaways.

- Quick escalation from an FA to a C&D demonstrates the OCC's tightening grip on the Bank and reflects a belief that it could not address its issues without a stronger mechanism in place.
- The action is based in part on the Bank's failure to *correct* known problems in its compliance program, a statutory power it utilizes less often and typically reserves for repeat offenders.
- The C&D mandates the BSA officer to be limited to BSA/AML responsibilities—no dual hats.
- The C&D article on third-party risk management explicitly covers "fintech partners" and another level down– so-called "sub-partners"–applying all corrective actions to both categories.
- The C&D highlights the importance of due diligence before bringing on new partners, especially those providing technological solutions. Banks must review their partners' BSA/AML programs.
- Failure to address third-party risks can lead to a complete bar on new fintech relationships.

Bottom Line. The C&D should be read to complement recent interagency TPRM guidance and outline the OCC's supervisory expectations for an adequate baseline of fintech partner oversight.

CFPB Updates Supervisory Appeals Process

Summary. On Feb. 16, the CFPB announced revisions to its internal processes for financial institutions to appeal supervisory findings from examinations, the first update since 2015. The changes include: expanding to a broader range of Bureau officials eligible to review the appeal (outside of Supervision); including an option to remand to staff for a modified finding, allowing a middle ground between upholding or rescinding the finding; and permitting appeals for any compliance rating, not just adverse ratings. The revisions were issued through a procedural rule.

Takeaways.

- As with the bank regulators, the scope of appealable matters is limited. Enforcement-related decisions, including initiations of investigations, remain outside the CFPB's appeals process.
- The Bureau still expects most entities to resolve concerns during exams, not resort to an appeal.
- Prudential regulators won't be left out. The process includes solicitation of the agencies' views.
- The CFPB's stated commitment to ensure an appeal does not result in an adverse institutional effect is encouraging, but it remains to be seen how this will play out in contentious situations.

Bottom Line. The CFPB's process was long-overdue for revision and alignment with those of the bank regulators. But because of potential blowback effects, appeals will likely remain under-utilized.

Fed Vice Chair for Supervision Confirms Increased Agency Enforcement Activity Post-SVB

Summary. On Feb. 16, Federal Reserve Vice Chair for Supervision Michael Barr gave a speech at Columbia University Law School, covering the agency's supervision and enforcement efforts following the failure of Silicon Valley Bank (SVB) in 2023 and issuance of its post-mortem report.

Takeaways.

- In the Fed's regional bank program ($10B-$100B), the agency is assessing firms' condition, strategy, and risk management more frequently, and "deepening" the agency's supervisory interactions. The Fed is also coordinating more between the regional and large bank programs.
- The Fed will be conducting more horizontal supervisory examinations for large banks.
- Barr identified interest rate and liquidity risks as the focus of recent target exams, with examiners requiring more actions to address them. Barr also highlighted CRE risks, with all aspects of CRE risk management under scrutiny. This risk trio will be front and center in 2024.
- Confirming many banks' recent experiences, Barr stated that post-SVB, the Fed has issued more supervisory findings, downgraded ratings at a higher rate, and increased enforcement actions.

Bottom Line. Temporary capital or liquidity measures will be utilized far more. Expect the Fed to continue to escalate issues more quickly, use more sweeping actions, and keep them in place longer.

DoJ Warns on Redlining Exposure in Context of Mergers

Summary. On Feb. 5, the DOJ and the North Carolina Attorney General announced a settlement with First National Bank of Pennsylvania to resolve redlining allegations against the Bank, with the Bank agreeing to invest $13.5 million through several mechanisms designed to expand credit access. The DoJ and NC AG alleged that the Bank had engaged in a pattern or practice of lending discrimination by redlining predominantly Black and Hispanic neighborhoods in Charlotte and Winston-Salem. The allegations center around an entity that the Bank acquired in 2017.

Takeaways.

- The DoJ's Asst. AG and head of its civil rights division told reporters that banks should be "on notice" that they will be held accountable for redlining, even if conducted by an entity that they acquired or merged with. The agreement reflects application of successor liability to the Bank.
- She also stated that banks should know that the merger review process is "robust and active and aggressive," with the DoJ analyzing whether the parties have engaged in unlawful redlining.

Bottom Line. The DoJ continues its flurry of activity through its Combating Redlining Initiative. A vow to bring more focus on fair lending during the merger review could introduce a significant variable into the process, and should be an area of enhanced due diligence for potential acquirors.

Banking Groups Sue Federal Regulators to Block CRA Reform

Summary. On Feb. 5, several banking trade groups filed a lawsuit in the Northern District of Texas against the Fed, OCC, and FDIC to block implementation of the final CRA regulations. The plaintiffs almost immediately sought a preliminary injunction, alleging that member banks will suffer irreparable harm by expending resources to update their operations even in advance of the applicability of the rules.

Takeaways.

- The federal Fifth Circuit and district courts in Texas have been fertile ground for agency challenges, recently issuing a number of decisions limiting agency regulatory and enforcement authority.
- Plaintiffs argue the new regulations exceed the CRA's statutory authority by expanding assessment areas beyond banks' physical locations, and covering deposit in addition to credit products.
- The complaint focuses on the length and complexity of the final rules, and corresponding burdens on banks to first understand the new obligations and then operationalize systems to comply.
- The agencies' defense strategies may reveal differing approaches, viewpoints, and priorities.

Bottom Line. Plaintiffs aimed their suit at one of the most receptive judicial audiences for a challenge. An injunction could put the regulations on hold, but may introduce confusion as to whether banks should continue getting prepared for eventual applicability. The scope of any decision will be critical.

Other Developments That You May Have Missed . . .

- **FFIEC Issues Statement on Residential Lending Discrimination.** On Feb. 12, the FFIEC issued a statement on examination principles related to valuation discrimination and bias in residential lending. Notably, the statement instructs the bank regulators that evidence of discrimination in residential property valuation practices should be reflected in a bank's traditional ratings, as such practices could undermine credit decisions.

- **Bill Introduced to Reduce Merger Application Review.** On Feb. 16, Reps. Barr (R-KY) and Fitzgerald (R-WI) introduced the Bank Failure Prevention Act, which would require the Federal Reserve to act on merger applications within 90 days of receipt. The bill adds another wrinkle to the evolving regulatory landscape for merger reviews, following the OCC's recent proposal to eliminate certain streamlined applications and time-based approvals.

- **Bunq Withdraws U.S. Banking Charter Application.** On Feb. 7, Netherlands-based neobank "bunq" announced it had withdrawn its April 2023 application for a national bank charter, citing alleged issues between its home regulator and the OCC and FDIC. The withdrawal continues a trend that demonstrates the extremely challenging regulatory environment for de novo bank applications, especially those from non-traditional entities.

- **Bank Regulators Express Concerns on SEC Rule to Congress.** In January, Acting Comptroller Hsu and Federal Reserve Chair Powell sent letters to Rep. Barr expressing concerns that the SEC's proposed amendments to its safeguarding rule would upend bank custody practices by requiring segregation of cash into separate accounts. Without a shift in approach, banks will need to re-examine the viability of their custody service offerings.

- **Acting Comptroller Calls for Expanded Regulation and Supervision at Banking Peripheries.** In two recent speeches on Feb. 21st and 22nd, Acting Comptroller Hsu called on Congress to create a federal framework for money transmitters to avoid "contort[ions]" of bank charters, and suggested a consolidated supervisory approach for crypto-asset intermediaries. These speeches reinforce the Acting Comptroller's earlier statements regarding the importance of being proactive to expand the regulatory perimeter to address the pace of innovation, a concept he has applied to OCC supervision.