VOLUME No. 12

LUSE GORMAN

DECEMBER 2024

THE BANKERS' BULLETIN

Regulatory & Enforcement Insights on Recent Bank Industry Developments

In This Issue

1 The Potential Impacts of November Election on Bank Regulation & Enforcement

- As the saying goes, personnel is policy. Expect immediate changes at the top of the OCC and CFPB, and a reconfiguration of the FDIC Board. Other senior level, influential personnel will also likely change over.
- Despite changes at the top, it will take time for priorities and new policy initiatives to filter down to staff examiners, who will likely continue to work on preset exam schedules with established objectives.
- Proposed regulations that have rankled the industry, including the FDIC's proposed corporate governance guidelines and brokered deposit revamp, are likely to be modified, if not withdrawn entirely.
- Trade group suits against the industry related to recently-finalized regulations, such as the planned revisions to the CRA or the credit card late fee rule, could quickly be settled, or the litigation dropped.
- In the meantime, leaders at each agency publicly committed not to issue new regulations before January.

2 FRB Issues Semiannual Supervision & Regulation Report

- Supervisory findings in areas of management and risk management increased across the system in 2024.
- The FRB is emphasizing monitoring credit conditions, especially office/multifamily concentrations and credit reserve levels. This focus is likely to continue with the new administration.

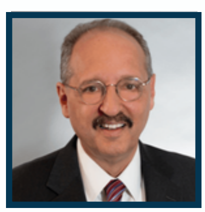
3 Financial Services Cmte. Chair Contender Proposes Community Banking Principles

- Rep. Hill calls for increased tailoring by the federal banking agencies at the regulatory and supervisory levels, based on risk profile, complexity, financial activities, business model, and capital structure.
- For M&A, Hill seeks a 120-day timeline for review, with applications deemed approved unless expressly denied, and wants to permit Reserve Banks to act on applications for small and mid-size banks that are 1 or 2 rated with Satisfactory CRA ratings or better. Alternatives to HHI are also being explored.

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.

Brendan Clegg
bclegg@luselaw.com



Marc Levy
mlevy@luselaw.com

Agata Troy
atroy@luselaw.com

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.*

The Potential Impacts of November Election on Bank Regulation & Enforcement

Summary. On Nov. 5, Donald Trump (R) was elected to a second term as President, and the GOP solidified control of both the House and the Senate. Republican control of both the legislative and executive branches will have major impacts on the personnel, policies, and priorities of the federal banking agencies, the CFPB, and the SEC beginning in Jan. 2025.

Immediate Takeaways.

Personnel Changes

- On Nov. 19, FDIC Chairman Gruenberg told FDIC staff that he plans to retire as chairman and as a board member effective Jan. 19, 2025. On Nov. 21, SEC Chair Gensler announced he plans to leave the agency on Jan. 20, 2025.
- On Nov. 22, President-elect Trump nominated hedge fund manager Scott Bessent as the Secretary of the Treasury.

Rulemaking Pauses

- At a Nov. 20 House Financial Services Committee hearing, Gruenberg, Acting Comptroller Hsu, and Federal Reserve Vice Chair for Supervision Barr publicly committed to not advancing new regulatory initiatives prior to January.

Predictions for the Next Administration. Banks should keep in mind that during the first Trump Administration, the banking agencies and the CFPB still issued rules and took enforcement actions; rulemaking and enforcement won't cease altogether.

Personnel Changes

- Expect prompt changes to the CFPB director, who can be fired, and for the OCC's acting head, who can be replaced.
- The FDIC Board will be entirely reshuffled due to Gruenberg's retirement, and replacements at the CFPB and OCC.
- There are open questions regarding the future of the FRB Governors, including Chairman Powell and Vice Chair Barr.

Supervisory, Examination and Enforcement Impacts

- It will take some time for changes in agency priorities, initiatives, and direction to filter down to staff level examiners and EICs: some changes in process may be immediate, but others may not take effect for another examination cycle or two.
- The shift by all the agencies towards quicker escalation to enforcement after SVB's failure will likely reverse to a degree.
- Agency enforcement priorities will likely shift, with junk fees and fair lending as candidates to be de-emphasized. Aggressive state regulators or AGs may look to fill a perceived gap in federal enforcement in areas such as UDAAP.
- Rhetoric around individual accountability and repeat offenders will likely cool, and focused initiatives will be wound up.
- Longstanding and recent proposed regs, like the brokered deposit rule, could be withdrawn or modified substantially.
- Agencies in active litigation involving recently-finalized rules, such as the CRA revamp, could pull back or settle.
- Use of tools other than notice-and-comment rulemaking (guidance, supervisory highlights, interpretive rules, speeches) will decrease; agencies will curtail reliance on regulation by enforcement, as with recent fintech-bank partnership actions.
- Guidance and interpretations that were issued without notice and comment will be rescinded or pared back.
- The agencies should be more receptive to activities that were not favored under the prior administration, including M&A, formation of de novo banks, reliance on novel charters, and engagement in digital asset and crypto activities.
- The next two months may feature a number of resolutions and settlements to longstanding investigations or actions, wrapping up matters prior to the start of the new administration. Keep an eye out for the CFPB pushing to close cases.

FRB Issues Semiannual Supervision & Regulation Report

Summary. On Nov. 21, the FRB issued its semiannual Supervision and Regulation Report detailing its supervisory and regulatory policies and actions, concluding the system remains sound and resilient overall.

Takeaways.

- Emphasizing points articulated by Vice Chair Barr following SVB's failure, the Report highlights that the agency is committed to improving the "speed, force, and agility" of supervision. This focus has led FRB examiners to shorten compliance windows and more quickly escalate issues into enforcement actions.
- The Report clarifies the FRB reviews fintech-bank arrangements under its Novel Activities Supervision Program, and emphasizes the agency's supervisory "experience" has identified safety and soundness, compliance, and consumer concerns with these programs' management. While highlighting perceived weaknesses, the Report acknowledges the FRB's ongoing efforts to understand how they work in practice.
- CRE and consumer loan sectors are noted as supervisory priorities, with underwriting standards, loan quality, and loss reserve levels specifically called out as areas under close agency monitoring. Other top-line priorities include liquidity risk management (especially funding pressures) and cybersecurity risk.

Bottom Line. Only one third of large banks had satisfactory ratings across all components in the first half of 2024, though the number of outstanding supervisory findings remained stable. Most community and regional banks remain in satisfactory condition, though some were downgraded, and the total number of outstanding supervisory findings increased in the first half of 2024. For community banks, IT and operational risk findings were the most cited outstanding issues, and management and risk management findings increased "notably."

Financial Services Committee Chair Contender Proposes Community Banking Principles

Summary. On Nov. 17, Rep. French Hill (R-Ark.), Vice Chair of the House Financial Services Committee and a contender for the Chair role next term, proposed a set of principles for the upcoming Congress and Trump Administration to guide legislative and oversight work related to community banks.

Takeaways.

- Hill, a former Arkansas community bank CEO, has highlighted his interest in revamping community bank supervision and regulation as a key component of his campaign to lead the Committee. He aims to raise the asset thresholds for CFPB supervision, qualification for an 18 rather than 12 mo. exam cycle, and the Small Bank Holding Company Policy Statement's allowance of debt financing.
- The principles seek to implement a periodic review by the agencies of the "cumulative impact" of all regulations, a point that trade groups have recently emphasized as regulatory burdens have increased.
- Regarding examinations, Hill wants more fairness, accountability, and transparency, and to develop a new appeal process. Hill also calls for openness at the agencies to innovation, coupled with the provision of clear supervisory expectations regarding banks' third-party relationships with fintechs.
- Some of the other principles reflect mainstream Republican sentiment, such as an end to the perceived agency initiatives to push banks to terminate relationships with certain industries, and to the push to implement separate climate-related regulatory mandates and frameworks for banks.

Bottom Line. As the potential Chair of this powerful Committee, many of these principles could end up in legislation or be pushed to the regulators via oversight. Hill has sought public comments by Dec. 31.

Other Developments That You May Have Missed . . .

- **House Ways and Means Committee Member Calls for Hearing on Credit Unions.** On Oct. 28, Rep. Claudia Tenney (R-N.Y.) called for Congress to hold an oversight hearing on credit unions at the ABA's Annual Convention. With an increase in credit union-bank acquisitions, Rep. Tenney advocated for public scrutiny of the tax treatment of credit unions. While re-examination of tax treatment for credit unions has not gained momentum in Congress, she could lead the GOP-controlled House in this effort.
- **FinCEN Issues Alert on Fraud Schemes Involving Deepfake Media Targeting Financial Institutions.** On Nov. 13, as part of a broader effort to provide financial institutions with information on challenges that may result from the use of AI, FinCEN issued an alert highlighting red flags to help those institutions detect, prevent, and report suspicious activity involving deepfake media. The alert suggests these issues can be surfaced by re-reviewing account opening documentation and proactively identifying inconsistencies.
- **Treasury's Bureau of Fiscal Service Rolls Out New Payee Name Validation Feature.** On Nov. 18, the Dept. of the Treasury's Bureau of Fiscal Services implemented a payee name validation ability for its Treasury Check Verification System, which will provide banks with additional data to prevent check fraud. This step is a notable process improvement in response to persistent calls from the industry for the federal government to devise solutions and new measures to address a marked increase in check fraud.
- **CFPB Takes Boundary-Pushing Enforcement Actions Against Credit Unions.** On Oct. 31, the CFPB issued an enforcement action including a $1.5MM civil money penalty against FL-chartered credit union VyStar, alleging the launch of a new online and mobile banking platform from a new provider that crashed and took months to restore was an unfair practice. The use of the "unfair" label for the roll-out of a new banking system demonstrates the Bureau's willingness to extend the boundaries of its UDAAP authority. On Nov. 7, the CFPB ordered Navy Federal Credit Union (NFCU) to refund more than $80MM to customers and pay a $15MM civil money penalty related to its overdraft practices, noting it was the largest amount the Bureau ever obtained from a credit union. The action again demonstrates Chopra's penchant for targeting the biggest fish with attention-grabbing penalties.
- **Recent Bank Failures Spawn Individual Enforcement Actions, Calls for Deposit Insurance Reforms.** On Nov. 18, CFPB's Chopra called for reformation to deposit insurance limits in the wake of the October failure of the First National Bank of Lindsay, noting that depositors for that bank were expected to take a loss while uninsured depositors from the spring 2023 failures did not. With Chopra likely to be out at the Bureau in January, the movement for deposit insurance reform appears stalled indefinitely. Also on Nov. 18, the FRB issued an order prohibiting the former CEO of Heartland Tri-State Bank in Kansas from the banking industry for embezzling nearly $50 million of bank funds, causing it to fail. The FRB's action follows on the former CEO's guilty plea in federal district court; the prohibition reflects the most severe individual penalty the bank agency can impose for misconduct.
- **Georgia Dept. of Banking and Finance (GDBF) Proposes Bank Rule Amendments.** On Nov. 18, the GDBF published a series of proposed amendments to its regulations regarding chartering, branch openings, and more; the rules tweak requirements applicable to Merchant Acquirer Limited Purpose Banks, a novel charter type that may become more popular after Fiserv's recent approval.
- **CFPB Expands Supervisory Perimeter Around Non-Banks.** On Nov. 21, the CFPB finalized a rule enabling the Bureau to supervise large non-bank entities that provide digital consumer payment transactions, expanding its supervisory reach to cover commonly used payment app providers. Earlier in the week, on Nov. 20, Acting Comptroller Hsu provided a written statement to the House Financial Services Committee calling for a chartering regime for nonbanks to close the regulatory gap. Given the change in administration and the willingness of industry to challenge new rules through litigation, the CFPB's rule may be pulled back or enjoined. The push-pull between efforts aimed at de-regulation and the creation of a consistent regulatory framework for fintechs and crypto will likely continue to play out within the executive and legislative branches early in the next administration.