LUSE GORMAN

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The Bankers' Bulletin

*Regulatory and Enforcement Insights on **Recent Bank Industry Developments***

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INDUSTRY SNAPSHOT

month over month

- ↓ OCC Charter Applications Filed: **2**
- ↓ FDIC Insurance Applications Filed: **0**
- ↓ FDIC Insurance Applications Approved: **2**
- ↑ Bank Enforcement Actions Announced: **4**
- ↓ Bank Enforcement Actions Terminated: **7**

***Check out what Luse Gorman was up to last month here*:**

Proposed Merger **($89.1M)** || Proposed Merger ($597.0M) || Completed Merger ($241.3M)

Federal District Court Allows Illinois Interchange Fee Prohibition Law to Stand

Summary

On Feb. 10, a federal district court rejected a request by several bank trade groups to permanently enjoin the Illinois Interchange Fee Prohibition Act, which bans issuers, acquirers, and transaction processers from charging certain fees.

Highlights

1) In a surprising turn, the court essentially reversed its own preliminary injunction it had granted in early 2025 in favor of national banks, FSAs, and out-of-state banks, after it had found the Act was likely preempted by federal law.
2) The court, leaning into the advanced stage of the litigation with the record having been fully developed, concluded that the Act "does not directly regulate banks" because they do not set the interchange fees on the portions of transactions made up of state and local taxes and gratuity; rather, those fees are set by the payment card networks.
3) The court determined the while the Act will be "indisputably disruptive," the Act affects the payment card network's fee-setting powers—rather than a power of banks—which differentiates the case from prior preemption precedents.

Practical Tips

- The court's acknowledgment that compliance with the Act will be "costly" is a major understatement: banks doing business in Illinois after July 1 will face significant operational burdens while new, untested controls will present risks.
- Banks continuing to operate in Illinois should immediately evaluate whether additional personnel and resources should be diverted to focus on compliance with the law, and consider expanding the scope of compliance reviews and audits.

Takeaway

The litigation is far from over, as the plaintiff bank and credit union trade groups filed a notice of appeal within days of the ruling. Whether the Seventh Circuit upholds the district court's decision, however, is unclear—the appeals court may not even act before the law's July 1 compliance date. With violations posing significant financial penalty exposure, banks will be pressed to quickly assess the procedural, staffing, systems, and controls changes that will be necessary. Similar laws are also pending in numerous other states, which could create a complex and evolving patchwork absent judicial intervention.

OCC Issues Proposal for New Bank Appeals Process

Summary

On Feb. 17, the OCC issued a notice of proposed rulemaking to establish a revised appeals procedure for its supervised institutions. If adopted, the appeals process would undergo its most significant overhaul since being implemented in 1996.

Highlights

1) The OCC's proposal caveats that many of the individual modifications under consideration will be influenced by public comments and could differ materially from the proposal. But the agency acknowledged that its reform efforts are being driven by banks' concerns that the current process is not fair or transparent, and they could be subject to retaliation.
2) The OCC proposes to replace its ombudsman at the top of the appeals decision hierarchy with a newly-formed appeals board, proposed to include the chief national bank examiner and two term appointees with relevant experience at a financial regulator, bank, or in the financial services sector, at a law or consulting firm or trade group.
3) The agency proposes to adopt a "de novo review" standard for the first time, weighing both sides' arguments evenly.

Practical Tips

- The OCC appears willing to allow an appealing bank to supplement the supervisory record with facts occurring after the challenged decision was made, suggesting continued efforts to complete corrective actions will be taken into account.
- Conclusions reached by the appeals board will be effectively binding on supervisory staff across the OCC. Banks can rely on helpful appeals decisions in specific areas as a relevant source of authority, even if not equivalent to formal guidance.

Takeaway

The OCC's proposal continues to hold the line on excluding most decisions around formal enforcement actions from the scope of its appeals process, although the agency appears willing to allow narrow challenges to examiner compliance with established policies. Overall, the proposal reflects leadership's awareness that its banks, for various reasons, do not use the current process. Support from the Comptroller, and public pledges to prohibit retaliation against appealing banks, should spur banks to consider filing targeted appeals. Public comments could meaningfully influence the final iteration of these reforms.

This month's big number:

$1MM

The amount the OCC estimates banks would save by reversing a supervisory determination such as an MRA in a successful appeal. The OCC calls this amount a "conservative" estimate reflecting the "lower end" of the range of cost savings for an engagement of necessary subject matter experts. The estimate was included in the OCC's proposed rule for its new appeals process, issued on Feb. 17.

FinCEN Grants Relief from Customer Due Diligence Rule Requirements

Summary

On Feb. 13, FinCEN issued an order granting exceptive relief to banks from requirements under its 2016 customer due diligence (CDD) rule, which imposed a requirement to identify and verify the beneficial owners of legal entity customers.

Highlights

1) The order allows banks to avoid identifying and verifying the beneficial owners of a "legal entity customer," including many types of businesses, each time the customer opens an account. Instead, those obligations will only be triggered in three situations: (i) when the customer first opens an account with the bank; (ii) any time thereafter when the bank has knowledge of facts that would reasonably call into question the reliability of beneficial ownership information previously obtained; and (iii) as needed based on the bank's risk-based procedures for conducting ongoing CDD.
2) FinCEN's experience during COVID with the PPP loan program, together with public comments, prompted the order.
3) The order continues a trend of pulling back discrete obligations within the BSA/AML framework. FinCEN suggests more changes to the CDD rule are coming. Notably, the bank agencies did not join this order, in contrast to recent practice.

Practical Tips

- If banks opt to take advantage of the relief, they should ensure their procedures reflect the change: a failure to match up written governance documents to the practices being employed by staff on the ground invites supervisory criticism.
- If a bank's ongoing CDD procedures suggest identification and verification of beneficial owners is needed, the bank must either obtain a certification or confirmation that the information is up-to-date and accurate, or get the info again.

Takeaway

Because banks must still identify and verify beneficial owners if they either have knowledge that calls into question the reliability of the information on file, or if their ongoing CDD raises a question as to the reliability of that information, banks may end up being forced to comply with the CDD rule's original obligations more often than expected if they change their procedures after this order, except for those business customers with whom they have a deep, transparent relationship.

FRB Proposes Rule to Codify Removal of Reputation Risk from Supervision

Summary

On Feb. 23, the FRB issued a proposed rule to codify the removal of reputation risk from its supervisory programs. The proposal follows an announcement last June that the FRB was removing reputation risk as a component of its exams.

Highlights

1) The FRB's proposal trails a similar one issued by the FDIC and OCC last October, and has the same goal: to solidify constraints on examiner decision making using a binding regulation that will be more difficult to unwind later. The FRB notes that in the past 10 years, the word "reputation" was mentioned in only 1.5% of bank MRAs/MRIAs issued.
2) Threaded throughout the proposal are references to the FRB's increased focus on core, material financial risks, a reflection of the agency's shift in supervisory focus as it moves away from soft, vague factors like reputational risk.
3) Compared to the FDIC and OCC proposal, the FRB version is far less prescriptive. This proposal does not spell out prohibitions on specific examiner actions, such as instructions to terminate or modify contracts with third parties.

Practical Tips

- The FRB's removal does not suggest it is loosening its focus on other risks. The proposal reminds banks the agency expects Board-supervised institutions to maintain strong risk management frameworks, focused on core financial risks.
- The proposal reiterates that the decision on whether to make a loan, open or close an account, provide any product or service, or modify the terms of a product or service rests with the bank, so long as the bank complies with the law.

Takeaway

In light of the FRB's efforts to remove this concept from its guidance and manuals last summer, and initiate training for its examiners, the major impact of this proposal will be in solidifying its longevity: a future Administration would need to repeal it through a rule. Interestingly, this proposal aligns with an emerging interagency trend in rulemaking and guidance. While the three federal banking agencies are generally aligned on supervision policy shifts, the FRB has moved at a more deliberate pace, opting to issue a less prescriptive version of a rule or guidance rather than join in with the FDIC and OCC.

> "This out-migration of origination and servicing has been costly for banks, consumers, and the overall mortgage system. In part, this results from over calibration of the capital treatment for these activities, resulting in requirements that are both disproportionate to risk and that make mortgage activities too costly for banks to engage. I see a path forward that incorporates both renewed bank participation in the mortgage market and a safe and sound banking system."
>
> **Michelle W. Bowman, Vice Chair for Supervision, Federal Reserve Board**
> *previewing planned changes to the capital treatment for mortgages and servicing rights,*
> at the American Bankers Association 2026 Conference for Community Bankers (Feb. 16)

OCC Proposes GENIUS Act Rule for Payment Stablecoin Issuers

Summary

On Feb. 25, the OCC issued a notice of proposed rulemaking to address all of the regulations the OCC is required to promulgate under the GENIUS Act, other than those related to AML or sanctions. Comments are due by May 1.

Highlights

1) The OCC's regulations will apply to, and it will have enforcement authority over, a subset of permitted payment stablecoin issuers, including subsidiaries of national banks and FSAs, and federal qualified, certain state qualified, and foreign payment stablecoin issuers. The OCC acknowledges its rules governing these entities will evolve over time.
2) For covered entities, the proposal lists permitted and prohibited activities, and includes provisions governing reserve requirements, redemption policies, minimum and ongoing capital requirements, and an operational backstop.
3) The proposal outlines an application process and details the factors to be considered, and requires directors and executive officers to submit IBFRs. Substantially complete applications will be approved in 120 days, unless denied.

Practical Tips

- Applicants will need to demonstrate the issuer's risk management program can meet the comprehensive scope detailed in the proposal, which will ensure issuers have developed systems for internal audit, service provider oversight, and IT.
- Applicants should generally prepare for full-scope exams at least annually, although this frequency can be modified. Issuers must also design processes for weekly, quarterly, and annual financial and compliance reporting cadences.

Takeaway

The OCC's comprehensive proposal encompasses requirements for nearly every facet of the operations of the payment stablecoin issuers that will be subject to its jurisdiction. But with over 200 questions for the industry within the proposal, the final rule could turn out to be dramatically different, assuming a deluge of public comments pushing for both more stringent and more lax requirements. The proposal's inclusion of a presumption that certain types of third-party arrangements constitute prohibited payments of yield on stablecoins (i.e., interest) could be affected by intervening crypto legislation.

Other Developments You May Have Missed Last Month . . .

Senate Democrats Urge OCC and FDIC to Rescind Unsafe or Unsound Practice Rule. On Feb. 5, a group of five Democrat Senators sent a letter to Comptroller Gould and FDIC Chairman Hill seeking withdrawal of the agencies' recently-proposed rule to establish a definition for "unsafe or unsound" practices. The Senators focused on the potential that the new, narrower definition would restrict the agencies' ability to use supervisory and enforcement tools tied to this definition, and observed that the standard may not allow examiners to step in early enough.

***Bottom Line*:** The Democrat opposition is unlikely to dissuade the plan to finalize the rule, which is expected to largely mirror the proposal. However, it is clearly on the radar of several Banking Committee members, including ranking member Elizabeth Warren. This could signal the rule—while less of a headline-grabber than other federal rules already passed or expected in 2026—could be a target if Congress flips next term.

OFAC Opens Portal for Self-Disclosures, FinCEN Opens Intake for Whistleblower Tips. On Feb. 6, OFAC opened a disclosure portal on its website allowing companies to self disclose potential sanctions violations and submit supporting documentation. On Feb. 13, FinCEN launched a webpage to confidentially accept whistleblower tips on fraud, money laundering, and sanctions violations, with accompanying documents.

***Bottom Line*:** The two Treasury departments' parallel efforts to encourage disclosure through new online portals could reflect staffing shortages at both agencies and a reduced capacity to review incoming materials. But use of websites to facilitate these submissions could reduce friction inherent in the prior processes, and the sites' ease of use could push a company or whistleblower on the fence to submit a disclosure or tip. Expect the agencies to publicly tout successful enforcement matters that started through these new channels, even if they are a ways away.

FRB Defends Denial of Golden Parachute Payment to Former Bank Executive. On Feb. 20, the FRB filed a brief in support of its motion for summary judgment in a case filed by a former Wells Fargo executive, in which he is challenging the denial of his Part 359 application to receive unvested restricted share rights awards—compensation normally prohibited, absent regulatory approval, due to the Bank's troubled condition.

***Bottom Line*:** The agencies' golden parachute payment decisions rarely become public—due in large part to the expense of challenging those decisions in federal court—so the brief provides a rare insight into the agency's mindset in approaching these applications. The brief evinces the agency's clear belief it has, and will exercise, substantial discretion in this area to balance the factors it is required to consider. The FRB also notably defended its assessment of the executive's personal culpability, despite finding he shared operational responsibility with others.

California State Court Issues Decision Rejecting "Rent-a-Bank" Argument. On Feb. 24, the California Superior Court issued a "tentative decision" rejecting the California Department of Financial Protection and Innovation's (DFPI) argument that a Utah bank in a bank-fintech partnership was a 'dummy' lender, and that the true lender, a financial technology platform and service provider, violated the state's consumer finance laws by originating loans above CA's interest rate caps. Under state law, the ruling still needs to be finalized before DFPI can appeal it.

***Bottom Line*:** Although this ruling was issued by a state trial court, the lengthy record and meticulous review of the relevant factors could make the decision a precedent that shapes the future of bank-fintech lending arrangements. The court had no problem concluding the bank was the true lender, relying on its identification on loan documents, control of the application and underwriting processes, use of its own funds to originate loans, and retention of title and ownership, among other things. The court also roundly rejected DFPI's argument that the loan could become usurious after it was made, finding a later sale or assignment to the fintech does not alter the interest rate's permissibility at origination.

About Us

Luse Gorman, PC is a Washington DC-based law firm that specializes in representing regional and community banks across the country. Our attorneys have served with the federal banking and securities agencies and regularly engage with these agencies on a broad range of complex and novel compliance, regulatory, enforcement, transactional, application, and licensing issues. Our firm also specializes in mergers and acquisitions, capital raising transactions, general corporate and securities issues, and tax, executive compensation and employee benefits matters.

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