LUSE GORMAN

Volume No. 30 | June 2026

The Bankers' Bulletin

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

In This Issue:

1 **FRB Issues Revised Statement of Supervisory Operating Principles**

- Updated principles, superseding those issued in October, set a very high bar for FRB examiners to issue MRAs and label practices unsafe or unsound. But by using an internal memo in lieu of a proposed regulation, staff can revert quickly under new leadership.

2 **FFIEC Proposes Revisions to the CAMELS Ratings Framework**

- The first proposed changes to the framework in 30 years emphasize material financial risks and are intended to increase ratings transparency. Examiners' overweighting of the management rating, which has dragged down composite ratings, will be curbed.

3 **FRB Seeks Public Comment on Proposal to Establish Payment Accounts**

- The FRB has pushed its "payment account" alternative to a full master account forward by requesting comment on proposed revisions to its governing policies, coinciding with an Executive Order requesting the FRB expand access for financial companies.

4 **OCC's Semiannual Risk Perspective Identifies Key Industry Risks**

- The Spring 2026 edition aligns with recent federal banking agency reports in identifying CRE segment risks, and operational risks such as cybersecurity and AML. New insights into managing AI and innovation risks are limited, while consumer risks are absent.

5 **CFPB Finalizes Revised Small Business Lending Rule Under 1071**

- Adjustments to the rule's thresholds, made by the Bureau's new leadership to those imposed under Director Chopra, have sheared nearly 1,500 banks from the rule's coverage and provided breathing room until 2028 before the requirements kick in.

Also covered in this month's edition:

- **Judicial Decision:** Second Circuit Rules New York's Escrow Account Law is Preempted for Second Time (May 5)
- **Judicial Decision:** Second Circuit Affirms Dismissal of Claims for Entitlement to a Fed Master Account (May 13)
- **Executive Order:** E.O. Signals Changes Ahead for CIP/CDD Rules and Credit Evaluation Around Immigration (May 19)
- **Court Filing:** Consumer Groups File Lawsuit Against CFPB for Proposed Changes to ECOA Regulation (May 27)

INDUSTRY SNAPSHOT

month over month

- ↓ OCC Charter Applications Filed: **2**
- ↓ FDIC Insurance Applications Filed: **2**
- — FDIC Insurance Applications Approved: **1**
- ↓ Bank Enforcement Actions Announced: **2**
- ↓ Bank Enforcement Actions Terminated: **7**

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

Transactions: Proposed Merger ($80.9M) || Completed Merger ($354.2M)

Legal Updates: SEC Proposed Rule on Filer Status || FFIEC Proposed Rule on CAMELS Ratings
SEC Proposed Rule on Semiannual Reporting || SEC Proposed Rule on Form S-3 Eligibility

FRB Issues Revised Statement of Supervisory Operating Principles

Summary

On May 1, the FRB's Division of Supervision and Regulation publicly released an updated Statement of Supervisory Operating Procedures, superseding the original version dated October 29, 2025. The New Statement expands on and clarifies the original.

Highlights

1) The updated Statement clarifies the standards under which FRB staff will (i) rely on federal and state primary regulators when rating BHCs and SLHCs; (ii) rely on a member bank's internal audit function to validate remediation of MRAs, and (iii) terminate issued MRAs and enforcement action requirements once the underlying deficiencies have been remediated.
2) For the first time, the FRB sets standards for issuing MRAs and identifying unsafe or unsound practices, setting a high bar that surpasses the proposed standards of the FDIC and OCC. For both, the FRB overlays a good faith standard, as examiners will be required to show it is "plausible" that they have sufficient evidence that the requisite harm will result.
3) The FRB will permit exceptions to the outlined standards, but reserves this for the Vice Chair of Supervision or a delegate.
4) The Statement encourages institutions to report failures to comply with the outlined principles to agency leadership.

Practical Tips

- Banks should make comprehensive summaries during exam exit meetings and check them against the later-issued reports, as the Statement stresses there should be no material differences in the criticisms communicated orally and then in writing.
- Self-identification of deficiencies and prompt, reasonably-scoped remediation will go a long way for member banks: the FRB pledges that taking these steps will give rise to a presumption that a supervisory observation, not MRA, should be utilized.

Takeaway

The updated Statement continues to lower the standard for FRB-supervised organizations seeking to challenge, and remove, supervisory criticism and requirements. The Statement's directive to communicate deficiencies in "plain language" should improve institutions' understanding of actual examiner concerns. At the same time, the FRB has now adopted thresholds for using core supervisory tools that go beyond those to be used by its sister agencies, suggesting they will be used infrequently. Without codifying these changes into regulation, however, they are susceptible to quick modification in the future.

FFIEC Proposes Revisions to the CAMELS Ratings Framework

Summary

On May 19, the FFIEC issued a notice of proposed rulemaking to revise the Uniform Financial Institutions Rating System, commonly known as the CAMELS framework, the first revisions initiated since 1996. Comments are due by August 17.

Highlights

1) The proposed rule is intended to strengthen the link between CAMELS ratings and safety and soundness by focusing ratings on factors that materially affect financial condition and risk profile, as well as ratings transparency. Definitions for composite ratings will emphasize material financial risks while downplaying policy and documentation-related concerns.
2) The agencies will remove the direction that examiners give "special consideration" to the management component rating, acknowledging industry criticism that they have been overweighting this component, especially in recent years.
3) To warrant a "3" management rating, a bank must meet a material financial risk threshold, such as unreliable reporting or significant noncompliance with law. "Specialty" reviews, like BSA/AML or CRA, will have less direct effects on ratings.

Practical Tips

- Implementation of this change in approach will not be immediate. Exam teams will need to be re-trained, and adjustments will need to filter down through the agencies' ranks. But banks should look at their ratings with these principles in mind.
- Banks should consider utilizing all tools at their disposal—including appeals and discussions with regional leadership, among others—to challenge component and composite ratings that fail to meet the standards of this rule, once finalized.

Takeaway

The changes are a net win for banks. By providing more specificity in the factors that examiners evaluate and more consistency in the terminology and standards applied, while restricting flexibility for examiners to incorporate extraneous information into their ratings decisions, banks, management, and boards of directors should better understand the rationale behind their ratings and what is needed for improvement. Similarly-situated banks should also be treated more uniformly, and ratings should be less subject to variation based on the supervising agency responsible, or the geographic region where they are located.

This month's big number:

1

The number of criminal regulatory offenses that the OCC can enforce, as listed in a May 8 report issued by the OCC to comply with a 2025 Executive Order designed to provide transparency into federal agencies' authority and to combat "overcriminalization" in federal regulations. The only regulation listed, 12 C.F.R. 4.37, penalizes any person who discloses or uses OCC confidential supervisory information (CSI) with fines and up to 10 years in prison.

FRB Seeks Public Comment on Proposal to Establish Payment Account

Summary

On May 20, the FRB issued a notice and request for comment on proposed revisions to its policy and guidelines to allow the Federal Reserve Banks to offer special-purpose accounts to clear and settle payment activity, i.e., a "payment account."

Highlights

1) As envisioned by the FRB, a payment account will be a new, optional way for institutions to request access to a limited set of payment-related services, but they would not have access to master account features, like the discount window.
2) Reserve Banks will retain discretion to impose additional restrictions or remove access to certain of the covered services.
3) While they must be legally "eligible" to maintain a payment account, the FRB anticipates most entities seeking a payment account will be uninsured and fall into the "Tier 2" or "Tier 3" categories of its Access Guidelines for master accounts.
4) The day before the notice, the White House issued an Executive Order requesting that the FRB conduct a "comprehensive evaluation" of the framework governing access to payment services by non-bank financial companies, consider legal options for expanding those services, and establish a transparent application procedure for granting them access.

Practical Tips

- For Tier 2 and Tier 3 institutions, choosing a payment account should guarantee a faster decision time, as the FRB proposes only a 90-day review period, which the FRB acknowledges would be shorter than the review period for a master account.
- Because the FRB envisions certain conditions must be met by payment account holders to demonstrate a low risk profile, the FRB will require them to submit a new application to get a master account—it will not be a master account "on-ramp."

Takeaway

Despite some opposition from the industry, the FRB's steady march towards an alternative payment account has continued apace and will likely only be catalyzed by the push from the White House. The FRB's concurrent request that the Reserve Banks pause decisions on master account access requests from Tier 2 and 3 institutions until the proposal is finalized likely means pending requests will be stuck for months. Those institutions considering requesting a master account—perceiving a more receptive regulatory climate—may well be better off waiting until the new channel opens, now a foregone conclusion.

OCC's Semiannual Risk Perspective Identifies Key Industry Risks

Summary

On May 7, the OCC issued its Spring 2026 *Semiannual Risk Perspective* report, which observes that balance sheets remain strong, capital ratios and liquidity are high by historical standards, and bank earnings improved in 2025, driven by loan growth.

Highlights

1) Consistent with recent agency reports, this publication notes some "headwinds" in segments of CRE, though defaults are low, and in private credit, loans are generally performing as agreed, with some signs of credit quality weakening.
2) Within credit risk, the OCC notes that refinance risk in CRE portfolios merits continued attention, given that a substantial number of loans originated in a lower-interest rate environment will mature and need to be refinanced in the next few years.
3) Cybersecurity tops the list of operational risks, with threats posed by foreign actors and cybercriminal groups posing the greatest risk. Current geopolitical tensions could lead to an increase in targeting of banks and their service providers.
4) BSA/AML and sanctions risks, and strain on compliance systems, are increasing due to these same geopolitical tensions.

Practical Tips

- The OCC points to the potential benefits of AI to manage and defend against cyber-related risks—exacerbated, in part, by AI developments—but cautions that banks should have a sound understanding of the benefits and risks of these tools.
- Banks should continue to monitor FinCEN's published alerts on evolving fraud typologies, as the OCC directs attention to them as sources of red flags banks should be monitoring and incorporating into their risk management frameworks.

Takeaway

In a marked shift away from past *Risk Perspective* editions, the Spring 2026 edition does not even mention—let alone discuss—consumer compliance, fair lending, or CRA-related risks. The report's sections on AI and digital assets mostly recycle instructional language the banking agencies have used in these areas in other recent guidance issuances, cataloguing those publications while teasing future OCC activity around generative AI and agentic AI. While the report reiterates and emphasizes the OCC's stauncher support for innovation, time will tell how examiners on the ground view banks' adaptive uses of new tools.

While federal agencies are making life more expensive and enriching special interests, California will be firing on all cylinders to make sure markets aren't rigged against families and small businesses . . . . By bringing together dozens of boards, bureaus, and departments under one roof, California's new agency will work to protect the public in health care, technology, financial services, and more. I'm grateful to Governor Newsom for the opportunity to serve as the new agency's Secretary."

Former CFPB Director Rohit Chopra,
in a press release announcing his role as the leader of California's new Business and Consumer Services Agency, which will be opened on July 1, 2026 (May 12)

CFPB Finalizes Revised Small Business Lending Rule Under 1071

Summary

On Apr. 30, the CFPB issued its long-awaited revised rule implementing Section 1071 of the Dodd Frank Act related to small business lending. The publication of the final rule caps a nearly ten-year odyssey to implement this statutory provision.

Highlights

1) The rule significantly scales back the scope of the previous iteration of the rule, issued under Director Chopra in 2023. The CFPB describes its rejection of the use of broad, discretionary authority that Chopra relied on to layer on data collection requirements not outlined in the statute, instead opting to focus on "core" lending products, providers, and data points.
2) Consistent with the narrower scope the CFPB is now aiming for, the final rule raises the threshold for the number of small business loan originations needed to qualify as a covered financial institution from 100 to 1,000 in two straight years.
3) In addition, the rule makes favorable changes to the criteria for qualifying small businesses and eliminates dozens of data points the prior iteration of the rule would have required lenders to collect, in an effort to pare back the rule's complexity.

Practical Tips

- A significant number of banks that had been subject to the rule's reporting requirements will be excluded by these changes: the CFPB estimates that only 167-176 banks will be covered, and up to 1,450 banks will no longer be subject to the rule.
- Given all the delays in compliance dates engendered by court rulings and agency stays, the actual compliance timeline for the new reporting requirements could be easy to miss. Covered banks should be prepared to comply by January 1, 2028.

Takeaway

The circuitous route taken to achieve a final 1071 rule readily demonstrates the effect of sustained industry pushback—led by the litigation efforts that prompted a stay in compliance until the change-over in the Administration—to agency rulemaking. While the preamble to this rule discusses the possibility of incremental additions to the range of data points covered lenders must collect, it is more likely that the range will remain as is until a Democratic appointee returns. With a precedent set for both the expansion and contraction in the set of required data points, this rule could be subject to still more partisan swings.

Other Developments You May Have Missed Last Month . . .

Second Circuit Rules New York's Escrow Account Law is Preempted for Second Time. On May 5, the Second Circuit Court of Appeals concluded that New York's law requiring the payment of interest on escrow accounts is preempted. The Circuit's split ruling—which came back to the court after the Supreme Court in 2024 rejected the preemption test the appeals court used the first time around—provides a window into how courts will apply the precedent cases cited by the Supreme Court in deciding how significantly a state law interferes with the exercise of national bank powers.

***Bottom Line*:** The panel determined the New York law impedes the ability of national banks to offer escrow accounts "efficiently," a conclusion to which the dissent objected. Two other federal circuits already sided with the dissent, meaning that a patchwork of rulings on interest-on-escrow accounts has taken hold. Banks doing business across the lines of the different federal circuits will need to carefully evaluate how to treat these state laws and judge risks of non-compliance, especially given the OCC's two final rules on preemption of interest-on-escrow accounts issued May 15.

Second Circuit Affirms Dismissal of Claims for Entitlement to a Fed Master Account. On May 13, the Second Circuit Court of Appeals upheld a district court decision concluding that an uninsured Puerto Rican International Banking Entity (IBE) was not statutorily entitled to a master account with the Federal Reserve Bank of New York (FRB-NY). The IBE's account had been closed by the FRB-NY in 2022 over AML compliance concerns.

***Bottom Line*:** The decision is the latest in a series of recent federal court opinions nationwide finding Reserve Banks have discretionary authority to grant master account access, which includes the ability to close such accounts once opened. Although the FRB recently granted access to an uninsured, nonmember institution—an entity type its internal guidelines suggest should get strict review—the agency's litigation posture of vigorously defending use of flexible discretion continues. The new "payment" account may be the most viable means of access for Fed services.

E.O. Signals Changes Ahead for CIP/CDD Rules and Credit Evaluation Around Immigration. On May 19, the White House Issued an Executive Order (E.O.) entitled "Restoring Integrity to America's Financial System" designed to address risks the Administration cites to national security, public safety, and the financial services industry posed by illegal immigration. The E.O. requires the Treasury to issue a formal advisory containing red flags banks should consider related to the risks to the financial system posed by "non-work authorized populations and their employers."

***Bottom Line*:** The E.O. also requires, within 90 days, Treasury to consult with the banking agencies and propose changes to the BSA's implementing regulations to strengthen customer due diligence requirements, including for the collection of information for beneficial owners of accounts. In addition, the E.O. requires the CFPB to consider clarifying how the effects of deportation and lost wages might affect borrowers' ability to repay loans under the "ability-to-repay" regulations and directs the banking agencies to issue guidance on credit risks of "non-work authorized" people.

Consumer Groups File Lawsuit Against CFPB for Proposed Changes to ECOA Regulation. On May 27, a coalition of consumer advocacy groups filed a complaint in the federal district court for the District of Columbia against the CFPB, challenging the Bureau's recent amendments to Regulation B, the implementing regulation for ECOA, eliminating use of disparate impact. The complaint alleges the rule does not reflect "reasoned decision-making" or a "good-faith effort" to implement ECOA, and that its "drastic turn" from longstanding interpretations is not based on evidence.

***Bottom Line*:** The lawsuit, challenging an agency's paring back of a governing regulatory framework, is the inverse of Biden-era legal challenges brought by trade groups protesting actions by the CFPB (and the banking agencies) to layer on new regulatory obligations. Following the end of agency deference, this court could find the CFPB's process to issue the rule failed to meet the requisite legal standards under the APA, and undo it.

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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