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Regulatory & Enforcement Insights on Recent Bank Industry Developments

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- The agencies missed an opportunity to provide more prescriptive guidelines to parties looking at M&A.
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2 FDIC Proposes Rule Requiring FBO Account Reconciliation and Recordkeeping

- The FDIC's quick regulatory reaction to address the controversy surrounding the failures of fintechs involved in deposit arrangements and the negative impacts to individual consumers.
- Banks with pooled accounts will need to update compliance programs and revisit vendor contracts.

3 CFPB Publishes Circular Interpreting Reg. E Overdraft Record Requirements

- Under the interpretation, failure to maintain proof of a consumer's affirmative consent for overdraft service enrollment exposes banks to Reg. E violations *and* potential UDAAP violations.
- The Circular is directed at consumer protection agencies, but still informative for industry compliance.

4 FHFA Issues Advisory Bulletin on FHLBank Member Credit Risk Management

- FHFA outlines its expectations for components of FHLB member credit risk management frameworks.
- To address criticisms of FHLB actions taken before the 2023 bank failures, coordination among stakeholders and regulators when FHLBs are considering lending to troubled banks is emphasized.

5 OCC Acting Comptroller Hsu Discusses the Evolution of Bank Supervision

- Hsu advocates for a shift away from a "check the box" mentality guiding agency examiners' findings.
- He also floats the concept of a category of "domestic systemically important banks" under the GSIBs.

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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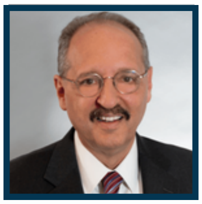

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Agencies Finalize Bank Merger Policy Statements

Summary. On Sept. 17, in a coordinated effort, the OCC and the FDIC finalized their respective policy statements on bank merger transactions, with few changes from their preceding proposals despite concerns raised by stakeholders. Although issued simultaneously, the OCC and FDIC do not align in substance or approach in all respects. The DoJ withdrew from its 1995 bank merger guidelines and announced that going forward, it would follow its newly-updated 2023 guidelines for bank mergers.

Takeaways.

- The OCC's statement makes clear integration planning will be critical: the agency will want to see a strategy and capacity for modernizing aging and legacy information technology systems. Mergers of equals will be marked for additional scrutiny, as will mergers where the resulting bank is $50B+.
- The FDIC expresses an expansive view of its jurisdiction in its policy: if a transaction looks like a merger in substance, regardless of form, the FDIC will expect a role in approving the deal. The agency's concentration analysis will encompass other products and services beyond deposits.
- The DoJ will utilize a new "addendum" to its existing guidelines that specifically addresses banking. Among other things, the DoJ will look at the range of products and services and types of customers the proposed merger will affect to analyze potential competitive harm.

Bottom Line. The new policies will undoubtedly lengthen the time agencies spend on reviewing applications, despite recent concerns raised by the industry, Congress, and FDIC Board members regarding lengthy review delays. Banks with pending applications have already seen follow-up questions derived from the statements, and they will continue to be the source for additional requests and documentation.

FDIC Proposes Rule Requiring FBO Account Reconciliation and Recordkeeping

Summary. On Sept. 17, in reaction to the controversy involving middleware provider Synapse, the FDIC issued a proposed rule aimed to ensure that banks determine the identity of the beneficial owners of deposits held in pooled or "for benefit of" accounts, and the amounts held by those owners.

Takeaways.

- The proposed rule applies to any insured depository institution that has a "custodial deposit account with transactional features"—an account held at a bank that commingles multiple beneficial owners' deposits and allows transfers to other third parties for things like paying bills.
- Under the proposal, banks would be required to maintain deposit account data in a format specified by the FDIC, and would need to establish controls allowing them to conduct reconciliations against their beneficial ownership records at least once per day at close of business.
- If a third party is involved in the arrangement, the bank must have "direct, continuous, and unrestricted access" to the records, including if the third party is disrupted, fails or goes bankrupt.
- Contracts with third parties will need to include specific provisions, including allowing an annual, independent validation of the third party's recordkeeping, which will be provided to regulators.
- The bank's CEO, COO, or other executive must certify compliance with the rule's requirements.

Bottom Line. As written, the rule would apply to any bank with a pooled account, and is not tailored to those specializing in these services or with many fintech partnerships. This rule is more likely than the FDIC's recent brokered deposit revisions to get finalized as drafted, given the agency's overall objective to provide clarity to individual deposit holders if intermediary third parties go bankrupt.

CFPB Publishes Circular Interpreting Reg. E Overdraft Record Retention Requirements

Summary. On Sept. 17, the CFPB published Circular 2024-05 addressing improper overdraft opt-in practices under the Electronic Fund Transfer Act (EFTA) and its implementing Regulation, Reg. E.

Takeaways.

- The CFPB concludes banks can violate the EFTA/Reg. E if there is no proof that they obtained consumers' affirmative consent to enroll in covered overdraft services before levying overdraft fees for ATM and one-time debit transactions. Such violations can support enforcement actions.
- The Circular was prompted by the Bureau's supervisory activities that found banks lacked relevant documentation, as well as non-compliance with internal policies requiring such evidence. The Bureau notes that the supervisory activities had already changed banks' retention practices.
- CFPB circulars are aimed not just at industry, but at the federal banking agencies with jurisdiction for institutions under $10B, and at state AGs and other state regulators with consumer protection enforcement responsibilities. Circular 2024-25 instructs these parties to inspect financial institutions' records to look for evidence of affirmative consent to enrollment in overdraft services.
- Of note, the "evidence" for a telephone opt-in is a call recording, potentially expanding the universe of recordings that a bank must maintain, driving up costs and compliance burdens.
- The Circular also threatens that "depending on the circumstances," a bank's overdraft practices may implicate the Bureau's UDAAP authority, allowing the CFPB more leeway to frame a case.

Bottom Line. Adding to the line of non-regulatory measures employed to drive industry behavior, the Circular's interpretation exposes banks to technical violations that could prompt per-violation CMPs.

FHFA Issues Advisory Bulletin on FHLBank Member Credit Risk Management

Summary. On Sept. 27, the FHFA issued an advisory bulletin on Federal Home Loan Bank (FHLB) member credit risk management intended to memorialize its "longstanding expectations" that FHLBs' underwriting and credit decisions should reflect members' financial conditions. FHLBs are expected to maintain a member credit risk management framework consistent with the advisory.

Takeaways.

- The advisory was issued to address recent FHFA examination findings of weaknesses in FHLBs' credit risk management and subsequent conclusion that FHLBs have misconceived the role they play, or should play, when lending to members in distressed conditions.
- The FHFA reiterates that FHLB lending frameworks should focus on member creditworthiness, and not primarily on pledged collateral. FHLBs should also ensure lending terms and conditions are commensurate with members' financial condition and capacity, and their willingness to repay.
- The advisory establishes an expectation that reviews should be conducted of members with poor financial health prior to fulfilling a funding request. In light of the FHLBs' activities pre-dating the 2023 bank failures, the guidance highlights the importance of communication and coordination with primary regulators, the Federal Reserve Banks, and FDIC when lending to troubled banks.

Bottom Line. FHFA continues to take regulatory and other measures to tighten up the processes FHLBs employ to lend to members, while also more explicitly addressing the perception that FHLBs have been serving as a lender of last resort and usurping the intended role of the discount window.

OCC Acting Comptroller Hsu Discusses the Evolution of Bank Supervision

Summary. On Sept. 3, OCC Acting Comptroller Hsu issued remarks to the Joint European Banking Authority and European Central Bank International Conference on the recent evolution of bank supervision, outlining necessary steps for supervision to continue to be effective in the future.

Takeaways.

- Hsu acknowledged that negative public headlines can cause examiners on the ground to become "unnecessarily cautious, defensive, or to second-guess themselves," which can lead to them sticking to checklists and processes rather than exercising "judgment and discretion."
- Hsu noted that recent changes in the industry, especially the increase in complexity and interaction with non-bank fintechs, have caused three important changes in supervision: (i) a "team of teams" approach, using a mixture of teams with different expertise across institutions, rather than a static exam team designated for every institution; (ii) covering non-financial risks, such as cyber risks, as financial risks; and (iii) the increased strengthening of supervision of large banks.
- Hsu highlighted the challenges posed by the proliferation of bank-fintech partnerships, and suggested the agencies create a framework for "domestic systemically important banks" or DSIBs.
- Hsu underscored the need for agency executives, rather than examiners, to take accountability.

Bottom Line. Although Hsu advocated for a move towards risk-based supervision in the areas most in need of supervisory attention, combined with a de-emphasis of a "check the box" approach employed by examiners, it is likely the agencies will still proceed conservatively in the shadow of SVB's collapse.

Other Developments That You May Have Missed . . .

- **Senators Urge Direct Supervision of Fintechs and BaaS Providers.** On Sept. 11, Senators Warren (D-MA) and Van Hollen (D-MD) wrote to the FDIC, FRB, and OCC to raise concerns regarding the lack of oversight for banking as a service (BaaS) providers and fintechs that partner with banks, and to urge the agencies to utilize their existing supervisory authorities to examine them. Consistent Congressional pressure for granular regulation, rather than selective enforcement actions, could push the agencies to outline supervisory expectations through formal rulemaking.
- **State AGs Tell 10th Cir. to Back CO Interest Rate Opt-Out Law.** On Sept. 20, the AGs for 13 states and D.C. filed an amicus brief in the 10th Cir. suit, *Weiser v. Nat'l Ass'n of Industrial Bankers*, supporting Colorado's efforts to unwind a temporary injunction issued by the district court, which blocked a state law interest rate cap from applying to out-of-state banks. Contrary to longstanding legislative efforts to put state banks on par with national banks, the brief suggests the amici states are comfortable with national banks having a rate exportation advantage.
- **FRB Seeks Input on Discount Window Operations.** On Sept. 5, the FRB published a Request for Information (RFI) seeking public comment on various operational aspects of the discount window. The RFI indicates that industry input could prompt improvements that would encourage banks to more readily use the window, as the FRB continues its multi-pronged push to increase utilization and remove the window's stigma.
- **California Law Bans Certain NSF Fees.** On Sept. 24, California passed legislation prohibiting state banks and credit unions from charging NSF fees when consumers attempt to initiate a transaction that is declined instantaneously or near instantaneously due to insufficient funds. In opting to bar the fees outright, California has avoided the approach used by the CFPB to shoehorn such fees into its UDAAP framework.
- **FRB Vice Chair Barr Previews Liquidity Regulations.** On Sept. 26, Barr provided insights into potential FRB large bank liquidity regulations, including a requirement to maintain a minimum of available liquidity with a pool of reserves and pre-positioned collateral at the discount window. Commenting that any such regulations would be "tiered" based on size and would not apply to community banks, he noted that examiners view discount window use as appropriate, suggesting that a so-called "readiness requirement" for the window may be pushed down. Barr also noted that the FRB is reviewing treatment of types of deposits, which may lead to more scrutiny of uninsured deposit concentrations.