

# Bank Regulatory Developments

What to Expect in the Second Half of 2022

**Jeffrey Taft**

*Partner*

+1 (202) 263-3293

JTaft@mayerbrown.com

**Matthew Bisanz**

*Partner*

+1 (202) 263-3434

MBisanz@mayerbrown.com

**Kerri Webb**

*Associate*

+1 (202) 263-3252

KWebb@mayerbrown.com

# Presenters



**Jeff Taft** is a practice leader in the Financial Services Regulatory and Enforcement group. His practice focuses primarily on bank regulation, bank receivership and insolvency issues, payment systems, consumer financial services and cybersecurity/privacy issues. He has extensive experience counseling financial institutions, merchants, technology companies and other entities on federal and state banking and consumer credit issues.



**Matt Bisanz** is a partner in the Financial Services Regulatory and Enforcement group. He advises financial institutions on all major aspects of the operations of an insured depository institution, its affiliates, and its partners. He also has experience counseling clients on various derivatives and risk management regulatory issues and is a CPA.



**Kerri Webb** is an associate in the Financial Services Regulatory and Enforcement group. Her practice focuses primarily on consumer financial services regulation and enforcement.

# Agenda

- Community Reinvestment Act Proposal
- Climate-Related Risk Management
- FRB Master Account Litigation
- FDIC Advertising Rules
- Digital Asset Activities
- Investment Fund Relationships

# Community Reinvestment Act Revisions

- Under the Community Reinvestment Act (CRA) regulators must adopt rules to assess the record of each bank in fulfilling its obligation to the community
  - Assessment conducted through the examination process; typically every three years
  - Regulators assign each bank a rating and publicly release a written performance evaluation
  - Poor CRA ratings may preclude acquisitions, impede growth and limit permissible activities
  - Public disclosure of CRA ratings and performance may present reputational risk; ratings downgrades for consumer compliance enforcement actions

# Community Reinvestment Act Revisions (cont.)

- On May 5, 2022, the regulators jointly proposed comprehensive revisions to the CRA, the most substantive updates in over 25 years.
- Some of the key revisions include:
  - Clarification of eligible community development activities
  - Adjustments to requirements and eligibility of activities outside of facility-based assessment areas
  - New testing structures and data collection requirements, particularly for the largest banks

# Community Reinvestment Act Revisions (cont.)

- Key Takeaways
  - The largest banks are subject to the most complex and rigorous requirements
  - For large banks, there are new geographic assessment areas based on lending, as well as an evaluation of activities outside of assessment areas
  - CRA rating can be lowered based on any discriminatory or illegal practice, and regulators are not required to consider remedial actions
  - Implementation may be required 1 year after final rule publication
- Unclear how comments may impact the requirements under the final rule
- Comments are due August 5, 2022

# Climate-Related Risk Management

- Over the past several months, banking regulators have provided further commentary and draft guidance on climate-related risk
  - FDIC and OCC drafted principles for managing exposure for climate-related financial risks
  - FHFA's Strategic Plan added an objective focused on studying the effects of climate change on the housing finance system
  - The Federal Reserve and its members have made statements indicating that the Fed is developing scenario analysis to model potential financial risks associated with climate change and may integrate climate risk into stress testing

# Climate-Related Risk Management (cont.)

- In June, the Basel Committee on Banking Supervision finalized principles for managing and supervising climate-related risk
  - While these principles are not binding in the US, the US banking regulators will likely consider the finalized principles when finalizing their own climate-related risk guidance
- Current draft guidance focuses on governance and risk management
- Banking regulators will likely continue to publish guidance on how banks can manage climate-related risk



# Climate-Related Risk Management (cont.)

- While there are currently no new regulatory requirements specific to climate-related risk, guidance on how banks should evaluate and treat climate-related risk is being finalized
- Regulators may start asking banks about their strategies for managing climate change-related risks
- Unclear whether banking regulators will take more controversial actions, such as capital add-ons
  - Political pushback
  - Treasury Secretary Yellen has stated that it is too early to contemplate adjusting capital requirements in response to climate change

# FRB Master Account Litigation

- Federal Reserve Banks (FRBank) provide financial services to **depository institutions**, such as collecting checks and transferring funds
  - Depository institutions include insured banks and insured credit unions
- Depository institutions may open a “master account” with a FRBank or rely on another institution’s account to settle transactions
- FRBank must review and decide on each request for services/master account
  - Litigation involving other master account applications has not resolved questions regarding the degree of discretion that FRBank may exercise or timing for processing an application

# FRB Master Account Litigation

- Custodia Bank, Inc. is an **uninsured Wyoming depository institution** that was founded in 2020
  - Chartered as a “special purpose depository institution” to connect digital asset companies to the US payments system
- Custodia applied to open a master account with the Kansas City FRBank in 2020
  - Custodia also applied to become a member of the Federal Reserve System in 2021
- As of June 2022, neither the FRBank nor the Federal Reserve Board (FRB) had issued a decision regarding Custodia’s applications

# FRB Master Account Litigation

- In June 2022, Custodia sued the Kansas City FRBank and FRB for failing to process the master account application
  - Claims that delay in processing is unlawful and that standard for reviewing the application is unclear and harmful to Custodia
  - Also claims that delay is a violation of the Administrative Procedure Act and US Constitution
    - Constitutional claims relate to separation of powers, due process, and appointments clauses
  - Requests that court order Kansas City FRBank or FRB to decide on the application
  - Also requests that court order Kansas City FRBank or FRB to grant Custodia a master account
- Complaint asserts that Kansas City FRBank has determined that Custodia is eligible for a master account
  - Kansas City FRBank recently **revoked** the master account of another uninsured state institution after determining that it is no longer eligible for one

# FDIC Advertising Rules

- FDIA prohibits any person from misusing the name or logo of the FDIC, engaging in false advertising, or making knowing misrepresentations about deposit insurance
- In May 2022, FDIC issued a rule to implement the statutory prohibitions
  - FDIC noted that it had identified **165 instances of potential misuse** in 2019 and 2020
  - Does not affect the application of related criminal prohibitions under 18 U.S.C. § 709
- Final rule provides several illustrative examples of types of prohibited conduct
  - One example indicates that a person must identify the **specific bank or banks** at which consumers' deposits may be placed to avoid making a material omission

# FDIC Advertising Rules

- CFPB issued a circular in conjunction with the FDIC rule
  - Circular takes the position that conduct that violates the FDIC's rule also would be a deceptive act or practice under the Consumer Financial Protection Act
  - CFPB has indicated that it is concerned with representations about new financial products or services, especially those involving new technologies such as digital assets
- OCC issued a separate statement noting its concerns with representations by digital asset firms and fintechs that are now covered by the FDIC rule
- FDIC still considering updates to its signage rules

# Digital Asset Activities

- Banking organizations remain interested in engaging in digital asset activities
  - Much of the recent activity has involved banks partnering with digital asset companies to make products available to bank customers
  - Some banks may be delaying initiatives because of uncertainty in applying SEC's SAB 121, including whether it will be adopted by US banking regulators
- US regulators indicated in November 2021 that they would issue guidance throughout 2022 on whether specific digital asset activities are permissible for banking organizations
  - To date, **no further public guidance** on permissible activities has been issued
- Basel Committee recently issued a second proposal on prudential regulation of bank exposures to digital assets and plans to finalize it by year end

# Digital Asset Activities

- Insured state banks may engage only in activities that are permitted under state law and that are permissible for national banks
  - OCC has recognized that national banks may engage in certain activities, such as custody, but subject to prior approval and risk management
- In April 2022, the FDIC issued guidance requiring **insured state banks** to provide prior notice to the agency of any digital asset activities
  - Issued under agency's safety and soundness authority, but also mentions customer protection and financial stability concerns
  - Appears to be designed to maintain parity between national banks and insured state banks



# Digital Asset Activities

- In January 2022, the Federal Reserve Board issued a report on the benefits and risks presented by a potential US **central bank digital currency** (CBDC)
  - Requested public comment on various questions and comments were due in May 2022
- Agency appears to be a long way off from deciding on whether to issue a US CBDC, let alone issuing one
  - Some agency principals appear to be opposed to issuing a US CBDC

# Investment Fund Relationships

- Banking regulators increasingly are scrutinizing relationships between banking organizations and investment funds
- First, regulators appear to be concerned that some banks view the exclusions of the Volcker Rule as an independent authority to make investments or acquire control
  - E.g., bank affiliate acting as a GP to a fund generally controls the fund
  - However, banks and affiliates may invest in or control an investment fund only if it is permitted under (i) relevant organizational law (e.g., National Bank Act) and (ii) the Volcker Rule
  - Some banks may have legal opinions that address only the Volcker Rule

# Investment Fund Relationships (cont.)

- Second, regulators remain concerned that banks are not managing risks with respect to funds *as borrowers*
  - See recent OCC statement with respect to concentration risk and underwriting standards
- Banks should assess appropriateness of risk management practices for lending to funds
  - Ensure enterprise-wide risk aggregation of all counterparty exposures
  - Carefully manage accommodations and exceptions to risk management practices
  - Particularly for high-net worth and family office traders that are serviced by wealth management and private banking divisions
  - Review and conduct concentration risk analysis of exposures on a sector-by-sector basis
  - Monitor trends in underwriting standards, such as covenant-lite deals and interest-only, non-recourse loans
  - Quality of underwriting also relevant to retail banking

[Americas](#) | [Asia](#) | [Europe](#) | [Middle East](#)

[mayerbrown.com](https://mayerbrown.com)

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown. © Mayer Brown. All rights reserved.