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Banking and Financial Institutions Newsletter

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In this Issue:

I. Administration

President Trump Issues Executive Order Instructing Review of Financial Regulations

President Donald Trump on February 3rd issued an Executive Order (EO) detailing his Administration's core principles for financial regulation and instructing the Treasury Department to evaluate the extent to which all current laws, including the Dodd-Frank Consumer Protection and Wall Street Reform Act, promote these objectives. The EO directs the Treasury Department to consult with the Financial Stability Oversight Council and issue a report within 120 days on federal policies that are inconsistent with the core values.

The directive identifies the following six principles of financial supervision:

1. Provide Americans with tools to make informed financial decisions;
2. Prevent taxpayer-funded bailouts;
3. Implement "more rigorous regulatory impact analysis" that considers both systemic risk and market failures;
4. Facilitate competition between American and foreign firms;
5. Prioritize American interests in international financial forums;
6. "Rationalize" the federal financial regulatory structure and once again make financial agencies accountable to the public.

Importantly, the EO specifies that it does not impede nor affect any authority that already has been granted to a department or agency.

Source: "Presidential Executive Order on Core Principles for Regulating the United States Financial System." The White House. February 3, 2017. https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

II. Regulatory Agencies

Court to Rehear CFPB Constitutionality Case
Denies Democratic AG Motion

The U.S. Court of Appeals for the District of Columbia Circuit has decided to rehear a case that may determine the future of the CFPB.

Central to the debate over the agency is an October 2016 ruling by a group of appeals courts judges that found the agency's structure unconstitutional (*PHH Corp. v. Consumer Financial Protection Bureau*). The determination also signified that the CFPB's Director could be fired at the discretion of the President. Under current statute, the Director may be fired only for cause, such as wrongdoing. The CFPB asked for an en banc review of the October decision.

The Court in particular is seeking arguments regarding whether CFPB violates Article II of the Constitution and if "the proper remedy [is] to sever the for-cause provision of the statute." It has instructed the federal government to file a new brief by March 31st and will begin listening to arguments on May 24th. The plaintiff, mortgage company PHH Corp., must respond by April 10th.

Separately, two senior Democrats on the House and Senate banking panels asked the Court for permission to join the appeal. Rep. Maxine Waters (D-CA) and Senator Sherrod Brown (D-OH), the top Democrats on the House Financial Services Committee and Senate Banking Committee, on January 26th were represented in a filing stating that they "seek to intervene in this litigation because recent events have made it clear that their interests in preserving the leadership structure they voted for may no longer be adequately represented by the new Administration."

Their motion continued, "Critically, lawmakers also determined that the Bureau needed to be an independent regulatory agency in order to remain a vigilant guardian of American consumers' interests and avoid being unduly influenced by the financial industry. Congress thus made the CFPB director removable by the President only for cause, namely 'inefficiency, neglect of duty, or malfeasance in office.'" A DC-based think tank and law firm called the Constitutional Accountability Center filed the motion on behalf of Waters and Brown.

The Court also recently denied a motion by 17 Democrat state attorneys general to intervene in the case. The attorneys general filed a motion on January 23rd arguing that they should be involved in the case in order to preserve the CFPB's authority to enforce anti-fraud statutes in their states. Additionally, the attorneys general wrote that they are permitted to bring the case to the Supreme Court, a right not afforded to the CFPB.

The Court issued its denial in a per curiam order with no accompanying written opinion. PHH Corp. in its opposition to the attorneys general stated, "The motion [to intervene] is egregiously untimely, there is no good cause for the delay in seeking to intervene, and there is no standing to intervene." The plaintiff also argued that it was a "bridge too far" to claim that the attorneys general had a "legally cognizable interest in the 'independence' of the CFPB."

Sources: "Brown, Waters Ask to Join Case of Consumer Financial Regulator." *CQ News.* January 26, 2017. *(Available upon request)*

"Court agrees to revisit ruling against consumer bureau." *The Hill*. February 16, 2017. http://thehill.com/policy/finance/319936-court-agrees-to-revisit-ruling-against-consumer-bureau

"Federal Appeals Court Refuses to Let Democrat AGs and Consumer Groups Intervene in CFPB's Constitutionality Case." *ACA International*. February 2, 2017. http://www.acainternational.org/news/breaking-federal-appeals-court-refuses-to-let-democrat-ags-and-consumer-groups-intervene-in-cfpbs-constitutionality-case

Fed Governor Daniel Tarullo to Resign

Fed Governor Daniel Tarullo recently submitted his resignation to President Trump, effective April 5th.

Appointed by President Obama, Tarullo has served on the Board of Governors since January 2009. His term was set to expire in late 2022. Tarullo was instrumental in implementing the Dodd-Frank Act and became the Fed's de facto vice chair for supervision. The position was created under Dodd-Frank but Obama never formally nominated an official to the position.

Tarullo has called for regulatory relief from international capital rules for small lenders. In May 2015, he discussed his interest in relaxing Basel III risk-based capital requirements for community banks with less than $10 billion in assets and suggested re-adopting requirements that were more consistent with Basel I rules. His proposal would have allowed smaller banks to meet simpler, risk-weighted capital requirements rather than to hold capital in proportion to the risks taken by their businesses.

Tarullo's vacancy leaves President Trump three posts to fill on the Board of Governors.

Sources: "Fed's top voice on financial regulations resigns." *The Hill*. February 10, 2017. http://thehill.com/policy/finance/318964-fed-governor-tarullo-top-regulatory-expert-submits-resignation

"Spare small US banks from Basel requirements, says Fed." *Financial Times*. April 30, 2015. *(Available upon request.)*

CFPB Issues Prepaid Rule Guide
U.S. Senators Sponsor Resolution of Disapproval

The CFPB recently issued a small entity compliance guide to facilitate implementation of its Prepaid Rule governing prepaid accounts. The rule, finalized in October 2016, pertains to payroll card and government benefit accounts, and to accounts that are preloaded and redeemable at merchants or ATMs. Entities subject to this rule are financial institutions, as defined by the Electronic Fund Transfer Act (EFTA), that directly or indirectly hold a consumer account or that issue an access device and enter into an agreement with the consumer to offer EFT services.

The rule requires new types of account disclosures, periodic statements, and limited liability and error resolution procedures. It also contains provisions affecting overdraft protections that already are offered by some prepaid account issuers. With some exceptions, the rule is effective on October 1, 2017. A provision to report prepaid account agreements to the CFPB becomes effective October 1, 2018. CFPB promulgated the regulation using its authority under EFTA and the Truth in Lending Act (TILA).

One day after release of the compliance guide, a group of seven Republican Senators led by Senator David Perdue (R-GA) introduced legislation to strike the prepaid rule using their authority under the Congressional Review Act. This law allows Congress to prevent a rule from going into effect if both the House and Senate pass a resolution of disapproval, and it is signed by the President, within 60 legislative days of the rule's enactment. The resolution requires only a simple 51-vote majority for passage in the Senate.

"If the CFPB wants to continue to impose rules and regulations that impact every American's financial well-being, it must answer to the American people," said Senator Perdue. "As a business guy, I have experienced first-hand the impact overregulation has on growth and innovation. This rule is entirely too broad and would cripple the electronic payment marketplace which Georgians and millions of consumers across the country depend on." Perdue is a member of the Senate Banking Committee.

"This rule from the Consumer Financial Protection Bureau is a prime example of what happens when an unaccountable federal agency designs a one-size-fits-all plan," said Senator Mike Enzi (R-WY). "What we get is close to 1,700 pages of tedious regulations that impact businesses and have unintended consequences for consumers. It is time that Congress exercise what little oversight it has over this agency to try and hold it accountable to the American people." Enzi is Chairman of the Senate Budget Committee.

Sources: "CFPB Releases Prepaid Card Rule Small Entity Compliance Guide." *ACA International*. February 3, 2017. http://www.acainternational.org/news/cfpb-releases-prepaid-card-rule-small-entity-compliance-guide

"Prepaid Rule: Small entity compliance guide." *Consumer Financial Protection Bureau*. January 31, 2017. https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/20170131_cfpb_Prepaid_guide_V1.pdf

"Senators Intervene To Protect Prepaid Accounts From Sweeping Government Regulation." *U.S. Senator David Perdue.* February 3, 2017. http://www.perdue.senate.gov/news/press-releases/senators-intervene-to-protect-prepaid-accounts-from-sweeping-government-regulation-

CFPB to Explore Use of Alternative Credit Sources

The CFPB issued a request for public comment on the feasibility of using alternative data sources, such as cell phone bills or rent payments, to determine the credit worthiness of individuals who have limited credit histories. The agency stated that it seeks input on the benefits and risks of relying on this non-traditional information and that it additionally will consider future steps to "lower unnecessary barriers" to facilitate use of this data.

The agency has requested information regarding this proposal's potential effects on access to credit, impacts on costs and service, privacy implications, complexity burdens on consumers and lenders, and effects on specific populations. In its announcement, CFPB offered a non-exhaustive, suggested list of alternative data sources for consideration. These include:

- Checking account transaction and cashflow data;
- Personal history that may reflect consumer stability, such as total changes in residence, employment, phone number, or email address;
- Educational history;
- Social media connections and behavioral data such as shopping or browsing.

CFPB concluded that 26 million Americans are "credit invisible" while 19 million are "unscorable" due to insufficient credit files. It also stated that most of these individuals belong to underserved groups and are minorities, low-income, or young adults.

The request for comment also cited 2016 guidance from the Fed, OCC, and FDIC that discusses alternative data as a potential evaluation tool for regulators. CFPB stated, "The guidance identifies that banks' use of 'alternative credit histories' as a means 'to evaluate low- or moderate-income individuals who lack sufficient conventional credit histories and who would be denied credit based on the institution's traditional underwriting standards' could be considered an 'innovative and flexible practice…to address the credit needs of low- or moderate-income individuals or geographies' that examiners would consider in evaluating banks' lending practices under the Community Reinvestment Act (CRA)."

Comments are due by May 19, 2017.

Sources: "CFPB Explores Impact of Alternative Data on Credit Access for Consumers Who Are Credit Invisible." *Bureau of Consumer Financial Protection.* February 16, 2017. https://www.consumerfinance.gov/about-us/newsroom/cfpb-explores-impact-alternative-data-credit-access-consumers-who-are-credit-invisible/

"Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process." *Federal Register*. February 21, 2017. https://www.regulations.gov/document?D=CFPB-2017-0005-0001

FDIC Inspector General Finds Weaknesses in Cyber Vendor Contracts

The FDIC Office of Inspector General (OIG) released a report on February 14th that concluded contracts between financial institutions and technology service providers (TSPs) must be strengthened. OIG surveyed a total of 48 contracts between lenders and 19 different institutions, data produced during bank examinations, and issued three recommendations and proposed actions that FDIC should complete by October 2018.

Investigators determined that the majority of sampled contracts did not contain sufficient provisions to protect institutional interests or define clearly TSP responsibilities. In particular, the contracts did not provide clear definitions regarding "business continuity" and "incident response." OIG found that these flaws impacted the ability of TSPs to handle systems or services disruptions, and to report incidents to key stakeholders in a timely fashion. OIG also established that the work of FDIC and the Federal Financial Institutions Examination Council (FFIEC) in this field has not had sufficient time to impact the structure of these contracts. The report continued that while it would not be reasonable to demand a renegotiation of existing contracts, FDIC's Division of Risk Management Supervision (RMS) "encourages [institutions] to discuss business continuity and incident response concepts, guidance, and expectations with their service providers."

OIG issued the following recommendations for RMS in this area:

1. Advise institutions of the possible hazards associated with cyber vendor relationships;
2. Take steps to promote details in these contracts that specifically consider the risks to, and interests of, the institution;
3. Ensure that contracts contain clearly defined terms to address the expectations and responsibilities of each party.

Additionally, OIG proposed that RMS at a future date evaluate the progress that institutions have incurred in improving their vendor management relationships.

Source: "Technology Service Provider Contracts with FDIC-Supervised Institutions." *FDIC Office of Inspector General.* February 2017. https://www.fdicig.gov/reports17/17-004EV.pdf

III. Congress

Senate Banking Chairman Offers Insight on Dodd-Frank Relief Timeline, Goals

Senate Banking Chairman Mike Crapo (R-ID) recently suggested that action on comprehensive regulatory reform would move slowly in this Congress. Speaking at a conference co-hosted by the Mid-Size Bank Coalition of America, the Chairman provided his outlook on the timing and substance of potential financial legislation while sharing his priorities for the next two years.

Crapo referenced the difficult political environment in Washington as an impediment to clearing a number of important steps that are essential to effective legislating, such as confirming President Trump's nominees to key agency and cabinet posts. He called the confirmation process "a very slow process, much more slow than we have seen before," and concluded, "that impacts everything else."

Despite indicating that it would be particularly challenging in the Senate to reach consensus on wide-spanning legislative efforts, Crapo said that he intends to garner bipartisan support for his proposals. These include providing regulatory relief to community banks and regional lenders with more than $50 billion in assets. The Chairman also seeks to review Basel standards, the Financial Stability Oversight Council, and address significantly the management of Fannie Mae and Freddie Mac. A spokesperson for Crapo later added that the

Chairman estimates a housing bill may take as long as one to two years to complete.

Crapo's assessment of the timeline for financial reform is markedly more conservative than that of his counterpart, House Financial Services Committee Chairman Jeb Hensarling (R-TX). Hensarling in early February wrote a memo to members of his committee outlining proposed changes to the Financial CHOICE Act, a broad reform package that he had introduced last year and which he intends to bring up for consideration in coming weeks.

Crapo also referred to President Trump's February 3rd Executive Order (EO) detailing the Administration's core principles for financial regulation. The EO instructs the Treasury Department to evaluate the extent to which all current laws, including the Dodd-Frank Act, promote these objectives. It additionally directs Treasury to consult with the Financial Stability Oversight Council (FSOC) and issue a report within 120 days on federal policies that are inconsistent with the core values. Crapo commented that Treasury's report would be integral in shaping a bill in the Senate.

Fed Chairwoman Janet Yellen echoed Crapo's interest in completing the Treasury review at a February 14th hearing before the Senate Banking Committee. "I certainly do agree with the core principles," she stated. "I look forward to working with the Treasury secretary and other members of FSOC to engage in this review." She pledged to keep the Committee informed of the review throughout the process.

Sources: "Key Republican Casts Doubt on Quick Action to Dismantle Dodd-Frank." *Bloomberg*. February 15, 2017. https://www.bloomberg.com/news/articles/2017-02-15/wall-street-rule-changes-will-move-slowly-in-senate-crapo-says

"Presidential Executive Order on Core Principles for Regulating the United States Financial System." *The White House*. February 3, 2017. https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

"Yellen Looks Forward to Regulatory Review, Praises Dodd-Frank." *CQ News*. February 14, 2017. *Available upon request.*

House Financial Services Committee Approves Oversight Agenda

The House Financial Services Committee on February 7th approved its committee agenda for the next two years and named the following areas of focus:

1. *The Dodd-Frank Act.* The Committee highlighted its intention to evaluate the role of the Volcker rule in the health of U.S. capital markets, the Consumer Financial Protection Bureau's (CFPB's) structure and funding mechanism, and implementation of "too big too fail."

2. *Financial institutions and consumer credit*. Items under this category include Basel III, recent rulemakings by CFPB and other agencies on mortgages, and oversight of agency activities related to Operation Choke Point. The Committee also agreed to "review issues related to the health, growth, safety, and soundness of community financial institutions, including the effect of regulations promulgated pursuant to the Dodd-Frank Act, individually and cumulatively, on community financial institutions' role in lending to small businesses, fostering employment, and promoting economic growth."

3. *Capital markets*. The Committee will examine efforts by the SEC, FASB, and IASB to promote uniform international accounting standards. It will also evaluate regulation of asset managers, advisers to private funds, securitization and risk retention, and the performance of agencies such as SIPC and the MSRB.

4. *Housing*. The Committee will survey proposals to consolidate and wind down commitments at Fannie Mae and Freddie Mac, and will evaluate policies regarding real estate settlement procedures. It also will search for duplication and inefficiencies at HUD, the Rural Housing Service (RHS), and NeighborWorks America.

5. *Insurance*. This category includes the National Flood Insurance Program (NFIP), Federal Insurance Office, and the effect of international regulations on the broader insurance industry.

6. *Monetary policy and trade.* The Committee intends to conduct oversight of the Fed's monetary policy, its role in the payment system, and cybersecurity vulnerabilities. It also will consider how the International Monetary Fund (IMF)'s work aligns with U.S. interests, and its effectiveness in preventing money laundering and terrorism financing.

7. *Illicit financing*. This area will focus on operations within the Financial Crimes Enforcement Network (FinCEN) and how agencies and financial institutions are equipped to share information regarding terrorism financing.

Source: "Authorization and oversight plan of the Committee on Financial Services." *U.S. House of Representatives Committee on Financial Services.* February 7, 2017. http://financialservices.house.gov/uploadedfiles/crpt-115-hprt-ba-oversightplan.pdf

Democratic Senators Urge Colleagues to Preserve CFPB Structure

Senators Sherrod Brown (D-OH) and Elizabeth Warren (D-MA) wrote to fellow Democratic Senators detailing the CFPB's completed efforts over the past five years and asking them to preserve the agency's current leadership structure. Brown is the top Democrat on the Senate Banking Committee and Warren also is a member of the committee.

Brown and Warren wrote that "banking industry lobbyists" are driving the push for efforts to replace the CFPB's current sole director with a five-member commission, and that implementing this change "would cripple" the CFPB. Additionally, the Senators argued that small banks have benefitted from the CFPB and that the decline in the number of community banks had been occurring for decades before the creation of the agency.

The Senators raised the following with regard to small financial institutions:

- The CFPB does not have jurisdiction over banks with less than $10 billion in assets. Most compliance costs incurred by community banks are associated with anti-money laundering laws and the Bank Secrecy Act.

- The lack in de novo community bank applications is a result of new FDIC regulations and low interest rates.

- Data since the 2008 financial crisis indicate that income at small institutions rose 11.8 percent year-over-year and that loan growth at community banks has outpaced loan growth at larger institutions.

- A comparison of FDIC's quarterly banking reports demonstrates that banks of all sizes posted profits of $29 billion in 2011 Q1, prior to the opening of CFPB, compared to $43 billion in the most recent quarter.

Brown and Warren concluded their letter by encouraging fellow Senators to examine CFPB's consumer complaint database and to weigh the work of the agency against the consequences of installing a multi-member leadership commission. "Or consider the billions of dollars the agency has put directly back in the pockets of working families… and the rampant, pre-crisis consumer abuses, including predatory mortgage lending, that the agency has stamped out," they wrote. "All of this at risk – not just for a few years, but permanently – if we adopt a commission structure."

Source: Dear Colleague Letter to Democratic Senators. Senators Sherrod Brown and Elizabeth Warren. January 31, 2017. https://www.politicopro.com/f/?id=00000159-f7d0-da98-a77d-f7d5469b0001

House, Senate Introduce Targeted Reg Relief Bills

Members of the House and Senate this month introduced legislation designed to increase oversight of the federal banking regulators and ensure that future policies take into account the relative sizes of financial institutions.

Three new bills take aim at the CFPB. The Repeal CFPB Act, sponsored by Senator Ted Cruz (R-TX) and Rep. John Ratcliffe (R-TX), would strike an entire portion of the Dodd-Frank Act authorizing creation of the agency. In contrast, Senator David Perdue (R-TX) introduced the Consumer Financial Protection Bureau Accountability Act to make CFPB funding subject to Congressional oversight via the formal appropriations process. The CFPB presently is funded through the Federal Reserve. Sixteen Republicans joined Perdue on his bill.

Senator Mike Rounds (R-SD) introduced the TAILOR Act to require federal banking agencies to adapt proposed regulations to the specific characteristics of the institutions they oversee. The bill would require the OCC, Federal Reserve, FDIC, CFPB, and NCUA to report to Congress annually on how they factor a lender's business model and risk profile into the rules and guidance they promulgate.

"Excessive costs and regulatory hurdles continue to hurt consumers the most," said Senator Rounds. "The TAILOR Act would ease the regulatory burden on smaller financial institutions so they can focus their resources on taking care of their customers, rather than spending time and money on compliance, the costs of which are ultimately passed onto the consumer."

Sources: "GOP senators unveil bill to give Congress control of consumer bureau budget." *The Hill.* February 15, 2017. http://thehill.com/policy/finance/319681-gop-senators-unveil-bill-to-make-congress-control-consumer-bureau-budget

"Rounds Reintroduces Bill to Ease Regulatory Burden on Local Banks & Credit Unions." U.S. Senator Mike Rounds. February 14, 2017. http://www.rounds.senate.gov/newsroom/press-releases/rounds-reintroduces-bill-to-ease-regulatory-burden-on-local-banks-and-credit-unions

Rep. McHenry Asks Fed to Pause International Negotiating

Rep. Patrick McHenry (R-NC), Vice Chairman of the House Financial Services Committee, wrote to Fed Chair Janet Yellen urging her to cease the Fed's participation in international financial forums until President Trump has had an opportunity to appoint individuals to key posts.

McHenry called it "unacceptable" that the Fed has continued its involvement in international talks regarding monetary policy and regulatory standards without the support of the new Administration and a clear understanding of the President's goals. He argued that the Fed is participating in these discussions without the full authority of the new Administration. "Continued participation in international forums such as the Financial Stability Board, the Basel Committee on Banking and Supervision, and the International Association of Insurance Supervisors is predicated on achieving the objectives set by the new Administration," stated McHenry.

McHenry also questioned the structure of these international bodies and argued that the lack of transparency in their decision-making processes has contributed to harmful capital regulations affecting U.S. businesses, "leading to slower economic growth here in America."

Source: Letter to The Honorable Janet L. Yellen. Office of U.S. Representative Patrick T. McHenry. January 31, 2017. https://www.politicopro.com/f/?id=00000159-f7e3-d173-a959-fff3b1430001

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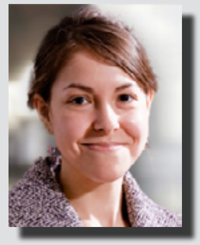

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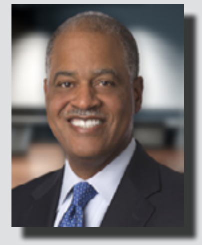

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