The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION June 2024

LexisNexis

THE BANKING LAW JOURNAL

VOLUME 141 **NUMBER 6** **June 2024**

LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call or email:

Matthew T. Burke at .... (800) 252-9257
Email: .... matthew.t.burke@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call or email:

Customer Services Department at . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . (518) 487-3385
Fax Number . . . . (800) 828-8341
Customer Service Website . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . (937) 247-0293

ISBN: 978-0-7698-7878-2 (print)
ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2024–Pub.4815)

Editor-in-Chief, Editor & Board of Editors

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW, Third Floor, Washington, DC 20005-2207.

Volume 141, Number 6

The Banking Law Journal
June 2024

Editor's Note
ESG

By Victoria Prussen Spears*

Financial institutions certainly must be aware of the "anti-ESG" movement growing across the United States. The lead article in this issue explains what they need to know about that. The other articles in this issue also provide guidance to financial institutions on new and developing topics. Read on!

ANTI-ESG

This issue of *The Banking Law Journal* begins with an article titled, "The Continued Evolution of the Anti-ESG Landscape for Financial Institutions." Here, Randy Benjenk and Emily Hooker of Covington & Burling LLP offer insights as to what financial institutions can expect from the growing "anti-ESG" legal movement across the United States during the balance of this year and beyond.

FINTECH

Last month, we published the first part of an article by Lerong Lu, titled, "Fintech Corporations: Defining the Practice and Regulation of Innovative Financial Enterprises." It examined the nature and meaning of Fintech and considered how artificial intelligence, blockchain, cloud computing, big data, and e-commerce have been applied to or integrated with financial institutions and markets.

---

* Victoria Prussen Spears is Senior Vice President of Meyerowitz Communications Inc. A graduate of Sarah Lawrence College and Brooklyn Law School, Ms. Spears was an attorney at a leading New York City law firm before joining Meyerowitz Communications. Ms. Spears, who is Editor of *The Banking Law Journal*, *Pratt's Journal of Bankruptcy Law*, *Pratt's Energy Law Report*, *Pratt's Government Contracting Law Report* and *Pratt's Privacy & Cybersecurity Law Report*, can be reached at vpspears@meyerowitzcommunications.com.

The second part of Dr. Lu's article, published here, discusses the main corporate structures and business models of Fintech, and outlines common characteristics of Fintech businesses. The third part of his article, which we will publish in the next issue of *The Banking Law Journal*, puts forward a brand-new regulatory framework for Fintech consisting of five pillars for sound and effective governance of Fintech: corporate finance and securities regulation, corporate governance and ESG, regulatory sandbox, regulatory technology (RegTech), and the balanced regulatory strategy.

CYBER RISKS

The article that follows, titled, "It's Not Your Fault, But It May Be Your Problem: Increasing Regulatory Scrutiny on Vendor Cybersecurity Risks," is by Kayleigh S. Shuler of Polsinelli PC.

In this article, the author explains how a vendor's data incident can be nearly as time-consuming, costly and reputationally damaging as an internal incident.

DATA BREACHES

Speaking of cybersecurity concerns, our next article is titled, "Looking Ahead to the Federal Trade Commission's Implementation of the Data Breach Notification Rule for Nonbanking Financial Institutions."

Here, Alexander D. Boyd and Colin H. Black of Polsinelli PC discuss a new rule requiring nonbanking financial institutions to notify the Federal Trade Commission within 30 days of discovering a data breach involving the nonpublic personal information of at least 500 consumers.

BANK MERGERS

Then, in the article titled, "U.S. Office of the Comptroller of the Currency Begins to Revamp Bank Merger Review Process," Michael D. Lewis and Matthew S. Katz of Sidley Austin LLP review a proposal by the U.S. Office of the Comptroller of the Currency that is a significant step in amending the Bank Merger Act framework and a hint of what is to come.

TERM DEBT

Kiel A. Bowen, Mark C. Dempsey and Andrew L. Hogan of Mayer Brown, authors of the article titled, "The Benefits of Term Debt Tranches in Fund Finance Products, and What to Consider When Utilizing Term Debt," explore how term debt tranches can bolster lending capacity and accommodate debt issuances.

CHARACTER AND FITNESS

The article that comes next is titled, "New York Department of Financial Services Adopts Final Guidance on Assessment of Character and Fitness of Directors, Senior Officers and Managers."

Here, Jarryd E. Anderson, Jessica S. Carey and Roberto J. Gonzalez of Paul, Weiss, Rifkind, Wharton & Garrison LLP discuss guidance issued recently by the New York State Department of Financial Services that suggests that, going forward, the Department will be more carefully scrutinizing character and fitness policies and procedures and their ability to guard against "compromised" directors and officers, as well as ordinary conflicts of interest.

FEES

Then, Andrew E. Bigart, Max Bonici, Michael M. Aphibal, David A. McGee and Brandon Wong of Venable LLP have an article titled, "Declined: Consumer Financial Protection Bureau Proposes Rule to Limit Nonsufficient Funds Fees."

In this piece, the authors review a rule proposed by the Consumer Financial Protection Bureau prohibiting financial institutions from charging nonsufficient fund fees on all "instantaneously or near-instantaneously" declined transactions.

Enjoy the issue!

\

The Continued Evolution of the Anti-ESG Landscape for Financial Institutions

By Randy Benjenk and Emily Hooker*[*]

In this article, the authors offer insights as to what financial institutions can expect from the growing "anti-ESG" legal movement across the United States during the balance of this year and beyond.

In the past several years, financial institutions have found themselves navigating an increasingly complicated and politically polarized landscape of laws and regulations centered around environmental, social, and governance (ESG) issues. These laws and regulations are pushing and pulling financial institutions in different directions on ESG issues, forcing them to take steps to ensure that their approaches to ESG do not inadvertently expose them to legal liability or reputational harm. This article offers insights as to what financial institutions can expect from the growing "anti-ESG" legal movement across the United States during the balance of this year and beyond.

BACKGROUND TO THE ANTI-ESG LEGAL MOVEMENT

For financial institutions, ESG is often associated with financial products like funds[1] or bonds[2] that meet certain criteria, as well as policies and initiatives around sustainability, racial equity, and corporate governance and corporate reports covering such policies and initiatives.[3] ESG products, policies, and initiatives are often responsive to stakeholder interests and demands. They also can serve as important components of financial institutions' risk management frameworks.

However, financial institutions' ESG initiatives and policies have increasingly been caught in the cross-hairs of well-organized efforts by conservative state attorneys generals, state financial officers, and non-governmental organizations

---

[*] The authors, attorneys with Covington & Burling LLP, may be contacted at rbenjenk@cov.com and ehooker@cov.com, respectively.

[1] See NerdWallet, 7 Best-Performing ESG Funds and 7 Cheapest ESG ETFs for March 2024 (Mar. 1, 2024), at https://www.nerdwallet.com/article/investing/best-esg-funds.

[2] See AB: ESG-Labeled Bonds: Are Greeniums Doomed To Dwindle? (Aug. 15, 2023), at https://finance.yahoo.com/news/ab-esg-labeled-bonds-greeniums-121500209.html.

[3] See, e.g. JPMorgan Chase & Co. 2022 Environmental Social Governance Report, at https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/documents/jpmc-esg-report-2022.pdf; Citi 2022 Environmental, Social, and Governance Report, https://www.citigroup.com/rcs/citigpa/storage/public/Global-ESG-Report-2022.pdf.

that have sought to characterize ESG as a political crusade[4] synonymous with big businesses' adoption of perceived progressive initiatives that may run counter to the interests of sectors such as the fossil fuel and firearm industries.[5] ESG's critics assert that financial institutions and/or pension funds are using ESG factors in investment strategies to the detriment of financial returns.[6] Some suggest that allegedly "woke" banks are denying access to financial services (so-called "de-banking") on the basis of customers' industries, political beliefs, or religious affiliations.[7] Some claim that federal regulators are to blame for pro-ESG policies, pointing to[8] an Obama-administration Department of Justice and FDIC initiative deemed "Operation Chokepoint" as an early effort to discourage banks from doing business with politically disfavored industries like payday lenders and gun retailers.[9] Former president Donald Trump even recently invoked the concept of politically-motivated de-banking on the campaign trail.[10]

---

[4] See WSJ, "An ESG Asset Manager Exodus," (Feb. 15, 2024); Elizabeth Pollman, The Making and Meaning of ESG, Research Paper No. 22-23 at p. 25 (ESG as Ideological Preference), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857.

[5] See, e.g. "Attorney General Ken Paxton Announces Barclays' Ineligibility to Participate in Texas's Bond Market For its Inability to Verify its 'ESG' Policies Do Not Violate Texas Law" (Jan. 26, 2024), at https://www.texasattorneygeneral.gov/news/releases/attorney-general-ken-paxton-announces-barclays-ineligibility-participate-texass-bond-market-its.

[6] See, e.g. "Tennessee Sues BlackRock in First-of-its-Kind Consumer Protection Suit over ESG Considerations" (Dec. 18, 2023), at https://www.tn.gov/attorneygeneral/news/2023/12/18/pr23-59.html; "Governor Ron DeSantis Signs Legislation to Protect Floridians' Financial Future & Economic Liberty" (May 2, 2023), at https://www.flgov.com/2023/05/02/governor-ron-desantis-signs-legislation-to-protect-floridians-financial-future-economic-liberty/.

[7] See, e.g. Karen Pierog, Wells Fargo escapes muni underwriter ban in Texas (Aug. 25, 2023), at https://www.americanbanker.com/news/wells-fargo-cleared-to-underwrite-municipal-bonds-in-texas; Letter from Jimmy Patronis, Florida Chief Financial Officer, to CEO Jamie Dimon, JP Morgan Chase Bank (Aug. 1, 2023), at https://myfloridacfo.com/docs-sf/cfo-news-libraries/news-documents/2023/chase-letter.pdf?sfvrsn=25b03a95_2.

[8] S. 19 (Tex. 2021) House Committee Report, at https://capitol.texas.gov/tlodocs/87R/analysis/pdf/SB00019H.pdf#navpanes=0.

[9] See Victoria Guida, Politico, "Justice Department to end Obama-era 'Operation Choke Point'" (Aug. 17, 2017), at https://www.politico.com/story/2017/08/17/trump-reverses-obama-operation-chokepoint-241767; Letter from Stephen E. Boyd, Assistant Attorney General to The Honorable Bob Goodlatte, Chairman, Committee on the Judiciary (Aug. 16, 2017), at https://alliedprogress.org/wp-content/uploads/2017/08/2017-8-16-Operation-Chokepoint-Goodlatte.pdf.

[10] Ja'han Jones, MSNBC, "Trump's rant about 'debanking' serves as a message to far-right extremists," (Jan. 18, 2024), at https://www.msnbc.com/the-reidout/reidout-blog/trump-speech-debank-extremists-jim-jordan-rcna134524; Lindsay Kornick, Fox News, "'SNL' mocked for

Against this backdrop, critics of ESG in statehouses across the United States have increasingly adopted laws and policies designed to crack down on the ability of governments and businesses to incorporate ESG considerations into their decision-making, investments, and corporate policies. As these anti-ESG laws and policies have proliferated at the state level in recent years, some companies have retreated from or deemphasized ESG or rebranded their ESG initiatives using more neutral terminology.[11]

At the same time, pro-ESG laws and policies that require, encourage, or at least permit entities to take note of factors like climate risk, carbon offsets, or a customer's industry have also gained significant support. This is true not only in states like California and New York, but also at the federal level with the SEC's recently proposed climate risk disclosure rule. Outside the United States, the European Union has recently passed a range of groundbreaking ESG regulatory initiatives, including the Corporate Sustainability Reporting Directive (CSRD), which in many cases have extraterritorial effect. In certain situations, anti-ESG and pro-ESG laws in different jurisdictions may come into tension or even direct conflict with each other.[12]

To assist financial institutions as they navigate this rapidly-evolving landscape, this article offers trends to watch in the anti-ESG movement for the balance of 2024 and beyond.

PREDICTIONS FOR THE ANTI-ESG MOVEMENT

1. State-Level Anti-ESG Laws Will Increasingly Fit into Familiar Patterns That Target Various Business Lines and Activities of Financial Institutions

Early anti-ESG laws were heterogenous efforts, with different states taking widely differing approaches to the applicability and scope of their anti-ESG laws. These laws impact a variety of distinct business lines, ranging from payment systems, retail banking, and government contracting to asset management. While newer legislation continues to target various parts of financial institutions operations, states are increasingly harmonizing their approaches within

their 'woke smugness' after claiming Trump made up the term 'de-banking,'" (Jan. 28, 2024), at https://www.foxnews.com/media/snl-mocked-woke-smugness-claiming-trump-made-up-term-de-banking.

[11] WSJ, "An ESG Asset Manager Exodus," (Feb. 15, 2024); WSJ, "Step Aside, ESG. BlackRock Is Doing 'Transition Investing' Now." (Mar. 3, 2024).

[12] Compare Cal. Fin. Code § 110001, at https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=FIN&division=26.&title=&chapter=&article=, with Florida Statutes § 790.335, at http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&URL=0700-0799/0790/Sections/0790.335.html.

different categories of anti-ESG laws. While not every bill fits neatly into these classifications – and we have not cited every active law or proposed bill falling under each – the categories below should serve as a general guide to the patterns we see continuing in 2024. Of course, state legislatures each operate with different legislative calendars, some of which adjourn early in the year. As such, some of the proposed bills described below may no longer be viable in 2024, though we believe they are helpful to understanding nationwide trends.

A. Merchant Category Codes and Financial Privacy

Merchant category codes (MCC) used in card payment networks are a particularly active area of anti-ESG legislation. In 2022, the Geneva-based International Organization for Standardization (ISO), the entity that manages global ISO MCC,[13] approved a code specifically for firearms retailers.[14] While political pushback reportedly slowed implementation of the firearm code last year, major payment networks are now said to be moving ahead with the use of the code.[15] California law will require payment card networks to make the firearms merchant category code available for merchant acquirers that provide payment services for firearms merchants beginning July 1, 2024,[16] and will require merchant acquirers to use the code beginning May 1, 2025.[17] However, the use of the firearm code remains controversial and has caught the attention of conservative politicians who have alleged, among other things, that banks have used MCCs to search and disclose private financial data as part of the January 6 Capitol attack investigations.[18] The interest in firearm MCCs is

---

[13] Kate Fitzgerald, American Banker, "Card networks halt plans for firearms merchant code" (Mar. 9, 2023), at https://www.americanbanker.com/payments/news/card-networks-halt-plans-for-firearms-merchant-code.

[14] Ross Kerber, Reuters, "Global standards body approves new merchant code for gun sellers" (Sept. 9, 2022), at https://www.reuters.com/world/exclusive-global-standards-body-approves-new-merchant-code-gun-sellers-2022-09-09/.

[15] John Adams, "Will California's gun law place a target on card networks?" (Feb. 12, 2024), at https://www.americanbanker.com/payments/news/will-californias-gun-law-place-a-target-on-card-networks?utm_source=newsletter&utm_medium=email&utm_campaign=V3_AB_Daily_2023%2B%27-%27%2B02132024&bt_ee=UpQ2pVFKtU3nZsKl4RTIWbcEgAFGHHXkw5aaAbRKZvE%3D&bt_ts=1707830766902.

[16] Cal. Fin. Code § 110001, at https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=FIN&division=26.&title=&chapter=&article=.

[17] Id.

[18] Letter from Ranking Member Scott to the Honorable Janet Yellen, U.S. Treasury, and Director Gacki, FinCEN (Jan. 19, 2024), at https://www.banking.senate.gov/imo/media/doc/rmscottlettertofincen11924.pdf; "CFO Jimmy Patronis: Florida is Fighting Back Against Feds for Flagging Americans on Political Beliefs" (Jan. 25, 2024), at https://myfloridacfo.com/news/

intertwined with a desire to limit the capacity of financial institutions to disclose private financial information related to firearm transactions. Regulation of MCCs that tag firearms transactions is an area of particular political interest at both the state and federal levels and may result in conflicting laws going forward.

- *Enacted Legislation*. A number of states have enacted anti-ESG laws governing the use of MCCs. For example, in Florida, financial institutions and other entities involved in payment card transactions are prohibited from assigning to a seller of firearms or ammunition an MCC that classifies the merchant as a firearms or ammunition retailer.[19] Idaho,[20] Indiana,[21] Iowa,[22] Mississippi,[23] Montana,[24] North Dakota,[25] Tennessee,[26] Texas,[27] Utah[28] and Wyoming[29] have all enacted similar restrictions around the use of the firearms codes. Some

pressreleases/press-release-details/2024/01/25/cfo-jimmy-patronis--florida-is-fighting-back-against-feds-for-flagging-americans-on-political-beliefs; "New Report Exposes Massive Government Surveillance of Americans' Financial Data" (Mar. 6, 2024), at https://judiciary.house.gov/media/press-releases/new-report-exposes-massive-government-surveillance-americans-financial-data.

[19] Florida Statutes § 790.335(2)(b), (c), at http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&URL=0700-0799/0790/Sections/0790.335.html.

[20] Second Amendment Financial Privacy Act, H. 295 (Idaho 2023), at https://legislature.idaho.gov/sessioninfo/2023/legislation/H0295/; Idaho Code Ann. § 18-3326A, at https://legislature.idaho.gov/statutesrules/idstat/title18/t18ch33/sect18-3326a/.

[21] Indiana House Bill 1084 (Ind. 2024), at https://iga.in.gov/legislative/2024/bills/house/1084/actions.

[22] H. 2464 (Iowa 2024), at https://www.legis.iowa.gov/legislation/BillBook?ga=90&ba=HF2464.

[23] Second Amendment Financial Privacy Act, H. 1110 (Miss. 2023), at https://billstatus.ls.state.ms.us/documents/2023/pdf/HB/1100-1199/HB1110SG.pdf, Miss. Code Ann. §45-9-207.

[24] S. 359 (Mont. 2023), at https://laws.leg.mt.gov/legprd/LAW0210W$BSIV.ActionQuery?P_BILL_NO1=359&P_BLTP_BILL_TYP_CD=SB&Z_ACTION=Find&P_SESS=20231, Mont. Code Ann. § 30-14-160.

[25] H. 1487 (N.D. 2023), at https://ndlegis.gov/assembly/68-2023/regular/bill-overview/bo1487.html, N.D. Century Code Ann. § 6-15-02.

[26] S. 2223 (Tenn. 2024), at https://publications.tnsosfiles.com/acts/113/pub/pc0773.pdf.

[27] Second Amendment Financial Privacy Act (Tex. 2023), at https://capitol.texas.gov/tlodocs/88R/billtext/pdf/HB02837F.pdf#navpanes=0; Texas Bus. & Comm. Code Ann. tit. 12, ch. 610, at https://statutes.capitol.texas.gov/Docs/BC/pdf/BC.610.pdf.

[28] H.B. 406 (Utah 2024), at https://le.utah.gov/~2024/bills/static/HB0406.html.

[29] S. 105 (Wyo. 2024), at https://www.wyoleg.gov/Legislation/2024/SF0105.

states – like Mississippi,[30] West Virginia,[31] Idaho,[32] Indiana,[33] Iowa,[34]– have included provisions in their laws that further protect privacy by restricting the ability of financial institutions to disclose financial records identifying transactions as involving firearms. Some laws also include provisions outlawing discriminatory conduct when processing transactions involving firearms.[35] In contrast, Colorado Senate Bill 66, signed by the governor on May 1, 2024, follows California's pro-ESG lead.

- *Proposed Legislation*. New legislative proposals could further complicate the compliance landscape for banks participating in the payment networks bills introduced in Louisiana, Missouri, New Hampshire, New Jersey, and Oklahoma,[36] would adopt more critical approaches toward the firearms MCC. Additionally, Florida Chief Financial Officer Patronis recently promised "new consumer protection legislation that will . . . prohibit financial institutions from sharing Floridians' private financial and transaction information."[37]

---

[30] Second Amendment Financial Privacy Act, H. 1110 (Miss. 2023), at https://billstatus.ls.state.ms.us/2023/pdf/history/HB/HB1110.xml, Miss. Code Ann. §45-9-207.

[31] The Second Amendment Financial Privacy Act, H. 2004 (W. Va. 2023), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=2004&year=2023&sessiontype=RS&btype=bill, W. Va. Code §31A-2B-4.

[32] Second Amendment Financial Privacy Act, H. 295 (Idaho 2023), at https://legislature.idaho.gov/sessioninfo/2023/legislation/H0295/; Idaho Code Ann. § 18-3326A, at https://legislature.idaho.gov/statutesrules/idstat/title18/t18ch33/sect18-3326a/.

[33] Indiana House Bill 1084 (Ind. 2024), at https://iga.in.gov/legislative/2024/bills/house/1084/actions.

[34] H. 2464 (Iowa 2024), at https://www.legis.iowa.gov/legislation/BillBook?ga=90&ba=HF2464.

[35] See, e.g., The Second Amendment Financial Privacy Act, H. 2004 (W. Va. 2023), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=2004&year=2023&sessiontype=RS&btype=bill, W. Va. Code §31A-2B-7.

[36] See, e.g. S. 301 (La. 2024), at https://www.legis.la.gov/legis/BillInfo.aspx?s=24rs&b=SB301&sbi=y; H. 2778 (Mo. 2024), at https://house.mo.gov/Bill.aspx?bill=HB2778&year=2024&code=R; H. 1186 (N.H. 2024), at https://legiscan.com/NH/bill/HB1186/2024; S. 1886 (N.J. 2024), at https://www.njleg.state.nj.us/bill-search/2024/S1866; H. 3221 (Okla. 2024), at http://www.oklegislature.gov/BillInfo.aspx?Bill=hb3221&Session=2400.

[37] "CFO Jimmy Patronis: Florida is Fighting Back Against Feds for Flagging Americans on Political Beliefs" (Jan. 25, 2024), at https://myfloridacfo.com/news/pressreleases/press-release-details/2024/01/25/cfo-jimmy-patronis--florida-is-fighting-back-against-feds-for-flagging-americans-on-political-beliefs.

B. Fair Access

In 2021, the OCC adopted though ultimately halted official publication[38] of a rule governing "Fair Access to Financial Services"[39] that would have required covered banks to (1) make each financial service they offer available to all persons in the geographic market served by the covered bank on proportionally equal terms; (2) not deny any person a financial service the covered bank offers unless the denial is justified by such person's quantified and documented failure to meet quantitative, impartial risk-based standards established in advance by the covered banks; and (3) not deny, in coordination with others, any person a financial service the covered banks offer.[40] Legislation that follows the general model of this halted rule is often referred to as "fair access" legislation, and sometimes is styled as an anti-discrimination law.

- *Enacted Legislation*. Approved by Governor Ron DeSantis on May 2, 2023,[41] Florida House Bill 3 enacted a sweeping set of anti-ESG measures applicable to certain financial institutions. Alongside requirements governing state government investment practices and prohibitions related to ESG bonds, the law requires qualified public depositories[42] and state-licensed financial institutions,[43] consumer finance licensees,[44] and money services licensees[45] to follow certain business practices. On May 2, 2024, Governor DeSantis approved amendments to the requirements established by Florida House Bill 3.[46] As amended by House Bill 989, the law generally requires that the provision of services or the denial of services be based on an analysis of risk factors unique to each customer and that a qualified public depository or a financial institution not engage in the unsafe and unsound practice of denying, canceling, suspending, or terminating services or otherwise discriminating against a person in making available such services or in

---

[38] OCC, "OCC Puts Hold on Fair Access Rule," News Release 2021-14 (Jan. 28, 2021), at https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-14.html.

[39] OCC, "Fair Access to Financial Services," at https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-8a.pdf.

[40] OCC, "Fair Access to Financial Services," 12 C.F.R. § 55.1, at https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-8a.pdf.

[41] Florida House Bill 3 (2023), at https://www.flsenate.gov/Session/Bill/2023/3.

[42] Florida House Bill 3 (2023) at Sec. 14; Florida Statutes Ch. 280.

[43] Florida House Bill 3 (2023) at Sec. 25; Florida Statutes Ch. 655.

[44] Florida House Bill 3 (2023) at Sec. 21; Florida Statutes Ch. 516.

[45] Florida House Bill 3 (2023) at Sec. 22; Florida Statutes Ch. 560.

[46] H. 989 (Fla. 2024), at https://www.flsenate.gov/Session/Bill/2024/989.

the terms or conditions of such services, on the basis of certain prohibited factors including:

  - A person's political opinions, speech, or affiliations;
  - A person's religious beliefs, religious exercise, or religious affiliations, except as permitted by the statute;
  - Any factor if not a quantitative, impartial, and risk-based standard, including any such factor related to the person's business sector; or
  - The use of any rating, scoring, analysis, tabulation, or action that considers a social credit score.[47]

- *Proposed Legislation*. Governor DeSantis has expressed hope that House Bill 3 could serve as "a blueprint" that members of the Governor's anti-ESG alliance, which unites Florida with 18 other states' governors opposed to ESG,[48] could use to implement similar measures in their own states. [49] Several bills that would have required that institutions to act based on quantitative, impartial, risk-based financial standards (and required that such standards be established in advance) failed to proceed to final legislation in 2023.[50] But in the early months of states' 2024 legislative sessions, a number of new bills have emerged that seek to establish Fair Access requirements echoing elements of Florida House Bill 3. For example, several newly proposed bills[51] – some of

[47] Florida House Bill 3 (2023).

[48] "Governor Ron DeSantis Leads Alliance of 18 States to Fight Against Biden's ESG Financial Fraud" (Mar. 16, 2023), at https://www.flgov.com/2023/03/16/governor-ron-desantis-leads-alliance-of-18-states-to-fight-against-bidens-esg-financial-fraud/.

[49] "Governor Ron DeSantis Signs Legislation to Protect Floridians' Financial Future & Economic Liberty" (May 2, 2023), at https://www.flgov.com/2023/05/02/governor-ron-desantis-signs-legislation-to-protect-floridians-financial-future-economic-liberty/.

[50] See, e.g., S. 1091 (Tenn. 2023), at https://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=SB1091&GA=113; H. 1283 (N.D. 2023), at https://ndlegis.gov/assembly/68-2023/regular/bill-overview/bo1283.html; S. 672 (Okla. 2023), at http://www.oklegislature.gov/BillInfo.aspx?Bill=sb672&Session=2300; L.D. 1546 (Maine 2023), at https://legislature.maine.gov/bills/display_ps.asp?snum=131&paper=HP0998; S. 637 (W. Va. 2023), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=637&year=2023&sessiontype=RS&btype=bill.

[51] See, e.g., H. 1205 (Ga. 2024), at https://www.legis.ga.gov/legislation/66831; H. 560 (Idaho 2024), at https://legislature.idaho.gov/sessioninfo/2024/legislation/H0560/; H. 669 (Idaho 2024), at https://legislature.idaho.gov/sessioninfo/2024/legislation/H0669/; S. 1167 (Ariz. 2024), at https://apps.azleg.gov/BillStatus/BillOverview/80624; S. 1337 (Ariz. 2024), at https://apps.azleg.gov/BillStatus/BillOverview/80853; S. 28 (Ind. 2024), at https://iga.in.gov/legislative/2024/

which would be titled the "Equality in Financial Services Act" – would seek to prohibit discrimination in the provision of financial services, with such discrimination defined to include the use of a "social credit score." Additionally, some similarly-themed bills from 2023 may be carried over[52] or re-introduced for consideration in 2024. A new "Fair Access to Financial Services Act" was reintroduced in West Virginia[53] after one failed to advance in 2023.

C. Procurement

Another common form of anti-ESG legislation seeks to disqualify companies from contracting with a state or local governmental entity if they engage in economic boycotts or discriminatory behavior, such as boycotts of the firearms or energy industries or against companies that refuse to meet certain emissions standards. Some laws require government contractors to verify that they are in compliance, and some laws require state regulators to maintain lists[54] of non-compliant firms that face limitations on their ability to contract with governmental entities.

- *Enacted Legislation*. There are already a number of anti-ESG procurement laws on the books across the country. Key examples include Texas

bills/senate/28/actions; S. Study Bill 3094 (Iowa 2024), at https://www.legis.iowa.gov/legislation/BillBook?ga=90&ba=SSB3094; H. File 2409 (Iowa 2024), at https://www.legis.iowa.gov/legislation/BillBook?ga=90&ba=HF2409; H. 452 (Ky. 2024), at https://apps.legislature.ky.gov/record/24RS/hb452.html; S. 2560 (Tenn. 2024), at https://wapp.capitol.tn.gov/apps/Billinfo/default.aspx?BillNumber=SB2560&ga=113; H. 2669 (Tenn. 2024), at https://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=HB2669&GA=113.

[52] See, e.g. L.B. 730 (Neb. 2023), at https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=50676.

[53] S. 214 (W. Va. 2024), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=214&year=2024&sessiontype=RS&btype=bill; S. 637 (W. Va. 2023), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=637&year=2023&sessiontype=RS&btype=bill.

[54] West Va. Code Art. 1c, at https://code.wvlegislature.gov/12-1C/; The Oklahoma Energy Discrimination Elimination Act of 2022, at http://webserver1.lsb.state.ok.us/OK_Statutes/CompleteTitles/os74.pdf#page=1230; Texas Office of the Attorney General, Letter to All Bond Counsel re "Additional Requirements for Statutory Representations and Covenants, Standing Letters, and Public Work Descriptions" (Nov. 1, 2023) ("Although not binding on this Office, a determination by the Comptroller that a company is a boycotter under chapters 808 or 809 will be given great weight and this Office will likely reach the same conclusion and rely on the Comptroller's determination until we have finalized our review."), at https://www.texasattorneygeneral.gov/sites/default/files/files/divisions/public-finance/ABCLetter-11-01-2023.pdf.

Senate Bill 19[55] and Senate Bill 13,[56] which require entities to certify that they do not discriminate against firearm entities or boycott energy companies, respectively. Texas Senate Bill 13 has been the subject of particular interest over the past year, as the Texas Office of the Attorney General commenced a review of whether companies that are members of a Net Zero Alliance were boycotting energy companies in violation of the law.[57] West Virginia recently made news with a potential expansion of its fossil fuel boycotter restricted institutions list.[58] Kentucky has a similar law addressing boycotting of energy companies.[59] Alabama Senate Bill 261, enacted last year, addresses a variety of types of boycotts, including but not limited to boycotts of the energy, timber, mining, and agriculture industries, as well as boycotts of businesses that do not commit to facilitate access to abortion or sex or gender change surgery or therapy.[60] Meanwhile, Idaho House Bill 190 requires the state's public depositories not to engage in certain boycott behavior.[61]

- *Proposed Legislation*. More proposed procurement laws have been presented for consideration. These proposals include Missouri House Bill 1699[62] and Missouri Senate Bill 1142,[63] which would address

[55] S. 19 (Tex. 2021), Tex. Gov. Code Ch. 2274, at https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2274.htm.

[56] S. 13 (Tex. 2021), Texas Gov. Code Ch. 2276, at https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2276.htm.

[57] See Letter to All Bond Counsel re: "Review Status of Net Zero Alliance Members" (Oct. 17, 2023), at https://www.texasattorneygeneral.gov/sites/default/files/files/divisions/public-finance/ABC%20Letter%20Draft%20Net%20Zero%20Alliance%2010.17.23.pdf.

[58] West Va. Code Art. 1c, at https://code.wvlegislature.gov/12-1C/; "Treasurer Moore Warns Six Additional Institutions of Potential Inclusion on Fossil Fuel Boycott List" (Feb. 26, 2024), at https://wvtreasury.com/About-The-Office/Press-Releases/ID/595/Treasurer-Moore-Warns-Six-Additional-Institutions-of-Potential-Inclusion-on-Fossil-Fuel-Boycott-List.

[59] Ky. Rev. Stat. Ann § 41.480, at https://apps.legislature.ky.gov/law/statutes/statute.aspx?id=52809.

[60] Act 409, S. 261 (Ala. 2023), at https://arc-sos.state.al.us/cgi/actdetail.mbr/detail?page=act&year=2023&act=409. This Alabama measure includes an important exemption applying to contracts related to financial products or financial advisory services.

[61] H. 190 (Idaho 2023), at https://legislature.idaho.gov/sessioninfo/2023/legislation/H0190/.

[62] H. 1699 (Mo. 2024), at https://house.mo.gov/Bill.aspx?bill=HB1699&year=2024&code=R.

[63] S. 1142 (Mo. 2024), at https://www.senate.mo.gov/24info/BTS_Web/Bill.aspx?SessionType=R&BillD=396.

several types of economic boycotts, and legislation in Nebraska[64] and West Virginia[65] that would protect the firearms industry from boycotts.

D. Divestment

Other anti-ESG legislation requires state entities to divest from companies deemed to be engaged in impermissible boycotting or discriminatory behavior, generally of energy companies. These anti-ESG divestment laws and bills contrast with pro-ESG divestment bills that require divestment from fossil fuel companies.[66]

- *Enacted Legislation*. Existing anti-ESG divestment statutes instruct state regulators in Kentucky,[67] Oklahoma,[68] Texas,[69] to compile lists of financial institutions deemed to boycott energy companies that will face divestment from state entities (as well as potential restrictions on procurement in some cases). Arkansas' blacklist is intended to cover entities that are deemed to discriminate against energy companies or firearms entities or otherwise refuse to deal based on environmental, social justice, and other governance-related factors.[70] In some of these states, a blacklisted financial institution can also be subject to restrictions on its ability to contract with governmental entities.[71]
- *Proposed Legislation*. In Oklahoma, the proposed "Firearm Industry

[64] L.B. 925 (Neb. 2024), at https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=54888.

[65] S. 275 (W. Va. 2024), at https://www.wvlegislature.gov/Bill_Status/Bills_history.cfm?input=275&year=2024&sessiontype=RS&btype=bill.

[66] See, e.g. H. 4083 (Oregon 2024), at https://olis.oregonlegislature.gov/liz/2024R1/Measures/Overview/HB4083; S. 198 (N.J. 2024), at https://www.njleg.state.nj.us/bill-search/2024/S198.

[67] Ky Rev. Stat. Ann. § 41.474, at https://apps.legislature.ky.gov/law/statutes/statute.aspx?id=52807.

[68] Energy Discrimination Elimination Act of 2022, at http://www.oklegislature.gov/BillInfo.aspx?Bill=hb2034&Session=2200, Okla. Stat. Ann. tit. 74 § 12003.

[69] S. 13, Tex. Gov't Code Ann. Ch. 809, at https://statutes.capitol.texas.gov/DocViewer.aspx?DocKey=GV%2fGV.809&Phrases=%22809.054%22&HighlightType=1&ExactPhrase=True&QueryText=%22809.054%22.

[70] Ark. Code § 25-1-1002.

[71] For example, the Texas Office of the Attorney General recently indicated that placement on Texas's divestment list will be "given great weight" in the Office's assessment of whether a particular institution should also be subject to contracting restrictions. Letter to All Bond Counsel re "Additional Requirements for Statutory Representations and Covenants, Standing Letters, and Public Work Descriptions" (Nov. 1, 2023), at https://www.texasattorneygeneral.gov/sites/default/files/files/divisions/public-finance/ABCLetter-11-01-2023.pdf.

Discrimination Elimination Act of 2024"[72] would create a list of institutions that boycott firearm companies and subject those institutions to divestment by state governmental entities and to restrictions on those institutions' ability to contract with governmental entities.

E. Investment Strategies, Asset Management, and Related Topics

Another category of anti-ESG laws governs the way that investment advisers and other asset managers invest public pension fund assets, and sometimes even how asset managers handle private funds. These anti-ESG laws sometimes require asset managers to consider solely "pecuniary" or financial factors in their investment decisions, and often regulate proxy voting decisions, as well.

- *Enacted Legislation*. One recently enacted example is the South Carolina ESG Pension Protection Act, which governs how the state Retirement System Investment Commission addresses proxy voting, among other issues.[73] Another prominent example is in the landmark Florida House Bill 3, which establishes requirements for how certain investment managers may handle public funds.[74] While the focus of this type of laws has often been on public funds, recently adopted *regulations* in Wyoming and Missouri have also targeted the way that investment advisers and broker-dealers conduct business with private clients.[75]
- *Proposed Legislation*. Among other anti-ESG investment strategy and asset management laws up for consideration in 2024, proposed Louisiana Senate Bill 5,[76] New Hampshire Senate Bill 520,[77] and Missouri House Bill 1700[78] would seek to regulate how public entities manage and invest funds, including requiring a fiduciary or proxy advisor to act based only on financial factors.

---

[72] H. 3222 (Okla. 2024) at http://www.oklegislature.gov/BillInfo.aspx?Bill=HB3222&Session=2400.

[73] H. 3690 (S.C. 2023), at https://www.scstatehouse.gov/billsearch.php?billnumbers=3690&session=125&summary=B.

[74] Florida House Bill 3 (2023), at https://www.flsenate.gov/Session/Bill/2023/3; Florida Statutes 215.4755, 215.855.

[75] "Governor Gordon Issues Line-Item Vetoes to Secretary of State's ESG Investing Rules" (Feb. 27, 2024), at https://governor.wyo.gov/news-releases/governor-gordon-issues-line-item-vetoes-to-secretary-of-state-s-esg-investing-rules; https://www.sos.mo.gov/cmsimages/adrules/csr/current/15csr/15c30-51.pdf.

[76] S. 5 (La. 2024), at https://www.legis.la.gov/legis/BillInfo.aspx?s=24rs&b=SB5&sbi=y.

[77] S. 520 (N.H. 2024), at https://gencourt.state.nh.us/bill_status/legacy/bs2016/billText.aspx?id=1959&txtFormat=html&sy=2024.

[78] H. 1700 (Mo. 2024), at https://house.mo.gov/Bill.aspx?bill=HB1700&year=2024&code=R.

2. For National Banks, Doctrines of Federal Preemption That Can Serve as Defenses to Enforcement of State-Level ESG Laws May Come Under Pressure

National banks may be able to avail themselves of federal preemption to avoid complying with certain types of state ESG laws. However, the applicability of preemption to state-level ESG legislation is largely untested, and the relevant doctrines of preemption may themselves soon evolve.

Generally speaking, under *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (U.S. 1996),[79] a state law that significantly interferes with a national bank's exercise of its federally-granted powers is preempted by the National Bank Act. Further, under the National Bank Act,[80] only the OCC or an authorized representative of the OCC is permitted to exercise "visitorial powers" with respect to a national bank.[81] Visitorial powers include the examination of a bank; inspection of a bank's books and records; regulation and supervision of activities authorized or permitted pursuant to federal banking law; and enforcing compliance with any applicable federal or state laws concerning those activities.[82]

The viability of these principles as impediments to states enforcing particular anti-ESG and pro-ESG laws against national banks requires case-by-case analysis, and may be put to the test as banks face continued enforcement under growing anti-ESG regimes. Moreover, there are practical limits to the use of preemption, including that national bank preemption generally does not extend to affiliates of national banks that are incorporated under state law.

Additionally, the law of preemption may soon change. On February 27, 2024, the Supreme Court heard arguments in the case *Cantero v. Bank of America, N.A.,* a case that will address whether the standard of National Bank Act preemption as articulated in *Barnett Bank* and codified in the Dodd-Frank Act prevents the application of state escrow-interest laws to national banks.[83] The Court's decision in *Cantero* may have knock-on effects in the ESG context.

---

[79] Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25 (U.S. 1996).

[80] See 12 U.S.C. 484.

[81] 12 C.F.R. § 7.4000(a)(1).

[82] 12 C.F.R. § 7.4000(a)(2).

[83] See Cantero v. Bank of America, ScotusBlog, at https://www.scotusblog.com/case-files/cases/cantero-v-bank-of-america/.

3. Non-Governmental Organizations Will Continue to Weigh in on and Seek to Shape the Development of State-Level Anti-ESG Policies

Politically-oriented non-governmental organizations will likely continue to engage actively in advocacy campaigns to shape the development of anti-ESG policies at the state level.

Model legislation has been a popular tool for these groups in the past. The American Legislative Exchange Council (ALEC) published, though ultimately did not adopt, a draft model policy[84] titled the "Energy Discrimination Elimination Act."[85] A final model policy, the "State Government Employee Retirement Protection Act" is currently available on the ALEC website.[86] A draft anti-boycott bill, the "Eliminate Economic Boycotts Act"[87] is currently available on the website of the Heritage Foundation, along with a draft "State Pension Fiduciary Duty Act."[88] One can see parallels between some of these model laws and laws that have been enacted across the country over the past few years.[89]

Non-governmental organizations will likely engage in other forms of advocacy, as well. Several large financial institutions have received shareholder proposals that would require these institutions to report on how they oversee the risks of de-banking customers based on religious or political views. Additionally, conservative think tanks such as the Heartland Institute have

---

84 See Thomas Savidge, ALEC, Liability Trap? Harvard Paper on ALEC Model Policy Gets Debunked (June 1, 2023) ("[T]he proposed 'Energy Discrimination Elimination Act' . . . was not adopted as ALEC model policy. . . ."), at https://alec.org/article/liability-trap-harvard-paper-on-alec-model-policy-gets-debunked/.

85 See Energy Discrimination Elimination Act accessible through the Internet Archive Wayback Machine, at https://web.archive.org/web/20211204022222/https:/www.alec.org/model-policy/energy-discrimination-elimination-act-2/.

86 See State Government Employee Retirement Protection Act (finalized Apr. 5, 2022; amended Aug. 28, 2023), at https://alec.org/model-policy/state-government-employee-retirement-protection-act/.

87 See Eliminate Economic Boycotts Act, at https://www.heritage.org/article/eliminate-economic-boycotts-act.

88 See State Pension Fiduciary Duty Act, at https://www.heritage.org/article/state-pension-fiduciary-duty-act.

89 See S. 13 (Tex. 2021), at https://capitol.texas.gov/BillLookup/History.aspx?LegSess=87R&Bill=SB13; The Oklahoma Energy Discrimination Elimination Act of 2022; S. 205 (Ky. 2022), at https://apps.legislature.ky.gov/law/acts/22RS/documents/0120.pdf; H. 2100 (Kan. 2023), at https://kslegislature.org/li/b2023_24/measures/hb2100/.

published articles in support of several anti-ESG bills under consideration in various states.[90]

4. While Anti-ESG Legislation May Move Quickly Through State Houses, It Is Far From Inevitable That Each New Anti-ESG Bill Will Be Adopted as Originally Proposed

Given the lack of political consensus regarding ESG, and fissures between pro-business and anti-ESG conservatives, anti-ESG measures will likely continue to encounter resistance at the state level. Bills may stall out or otherwise evolve in significant ways after introduction, and financial institutions should take note of prior successful efforts to make state legislation more workable.

For example, the final version of the economic boycotts procurement bill, Alabama Senate Bill 261, enacted last year, includes an important exemption applying to contracts "related to the issuance, incurrence, or management of debt obligations, to the deposit, custody, management, borrowing, or investment of funds, or to the procurement of insurance or other financial products, or financial advisory services."[91] The scope of this exemption is much broader than as it was originally proposed.[92]

Governors have also pushed back on anti-ESG measures that have passed the legislature, with varying levels of success:

- Last year, Governor Katie Hobbs of Arizona vetoed a proposed government procurement contract measure, Senate Bill 1096[93] that would have required public entities to obtain written certifications from contractors that they do not discriminate against firearm entities or trade associations. She explained: "This bill is unnecessary and, if enacted, could result in banks leaving Arizona's market. This would limit competition and increase costs for local governments, costs which ultimately fall on taxpayers."[94] This measure has, however, recently been re-introduced in a proposal to add the requirement through a

[90] Addressing H. 4 (Ohio 2023), S. 6 (Ohio 2023), H. 1699 (Mo. 2024), H. 1700 (Mo. 2024), S. 266 (Ga. 2023), S.F. 507 (Iowa 2023), L.B. 743 (Neb. 2023), H. 2777 (Okla. 2023).

[91] Alabama Senate Bill 261, enrolled, at https://alison.legislature.state.al.us/files/pdfdocs/SearchableInstruments/2023RS/SB261-enr.pdf.

[92] Alabama Senate Bill 261, introduced, at https://alison.legislature.state.al.us/files/pdfdocs/SearchableInstruments/2023RS/SB261-int.pdf.

[93] S. 1096 (Ariz. 2023), at https://apps.azleg.gov/BillStatus/BillOverview/78692.

[94] Veto Letter regarding Senate Bill 1096 (Mar. 28, 2023), at https://www.azleg.gov/govlettr/56leg/1r/sb1096.pdf.

ballot initiative.[95]

- Kansas House Bill 2100 became law last year without Governor Laura Kelly's signature, with the governor releasing a message citing "reservations about the potential unforeseen consequences of House Bill 2100 for the state and for local governments."[96]
- North Carolina House Bill 750 ultimately became law over Governor Roy Cooper's veto.[97] Governor Cooper's veto message explained: "This bill does exactly what it claims to stop. For political reasons only, it unnecessarily limits the Treasurer's ability to make decisions based on the best interest of state retirees and the fiscal health of the retirement fund."[98]

Additionally, policies may continue to evolve even after legislation is ratified. For example, several new bills have proposed alterations to the Oklahoma Energy Discrimination Elimination Act of 2022.[99] Meanwhile, California Governor Gavin Newsom raised questions regarding the upcoming implementation process for new pro-ESG California disclosure laws, Senate Bills 253 and 261, when his signing statements cited concerns with implementation deadlines and described plans to work with the Legislature to address concerns with the laws.[100] Wyoming Governor Gordon recently used line-item vetoes to pare back the scope of ESG regulations governing investment advisers and broker-dealers.[101]

---

[95] Senate Concurrent Resolution 1007 (Ariz. 2024), at https://apps.azleg.gov/BillStatus/BillOverview/80103.

[96] Message from the Governor regarding Kansas House Bill 2100, at https://kslegislature.org/li/b2023_24/measures/documents/hb2100_enrolled.pdf.

[97] H. 750 (N.C. 2023), at https://ncleg.gov/BillLookUp/2023/H750.

[98] Governor Cooper veto message regarding House Bill 750 (June 23, 2024), at https://webservices.ncleg.gov/ViewBillDocument/2023/6478/0/H750-BD-NBC-11016.

[99] See, e.g. S. 1510 (Okla. 2024), S. 1536 (Okla. 2024), H. 3222 (Okla. 2024), H. 3541 (Okla. 2024), H. 4014 (Okla. 2024). Draft bills are available on the Oklahoma State Legislature website at http://www.oklegislature.gov/BasicSearchForm.aspx?.

[100] Signing statement for Senate Bill 253, Senate Bill 261 (Oct. 7, 2023), at https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-253-Signing.pdf and https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-261-Signing.pdf.

[101] "Governor Gordon Issues Line-Item Vetoes to Secretary of State's ESG Investing Rules" (Feb. 27, 2024), at https://governor.wyo.gov/news-releases/governor-gordon-issues-line-item-vetoes-to-secretary-of-state-s-esg-investing-rules.

5. Financial Institutions Will Need to Ensure Compliance With Emerging Anti-ESG Measures Along With Emerging Pro-ESG Measures, Even Where Such Measures May Come into Tension With Each Other

Financial institutions will need to adapt their infrastructures to comply with new landmark pro-ESG policies and prepare for other pro-ESG measures on the horizon:

- As noted above, by July 1, 2024, California will require a payment card network to make the firearms MCC available for merchant acquirers that provide payment services for firearms merchants.[102] Merchant acquirers will be required to use such codes beginning May 1, 2025.[103]
- California Senate Bill 253[104] and Senate Bill 261[105] enacted landmark climate change disclosure laws that will require certain covered entities to prepare emissions disclosures and climate-related financial risk reports in the coming years to accompany required carbon offset disclosures under California Assembly Bill 1305.[106] Other climate disclosure measures have been proposed in Illinois[107] and New York.[108]
- The Securities and Exchange Commission finalized climate-related disclosure rules on March 6, 2024.[109]

Some pro-ESG and anti-ESG requirements may pose compliance challenges. For example, institutions making disclosures related to their management of climate risks will need to ensure that their statements cannot be misconstrued to indicate that they are energy boycotters in violation of an anti-boycott law

---

[102] Cal. Fin. Code § 110001, at https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=FIN&division=26.&title=&chapter=&article=.

[103] Cal. Fin. Code § 110001, at https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=FIN&division=26.&title=&chapter=&article=.

[104] S. 253 (Cal. 2023), at https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202320240SB253.

[105] S. 261 (Cal. 2023), at https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB261.

[106] A. 1305 (Cal. 2023), at https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240AB1305.

[107] H. 4268 (Ill. 2023), at https://www.ilga.gov/legislation/BillStatus.asp?DocNum=4268&GAID=17&DocTypeID=HB&SessionID=112&GA=103.

[108] A. 4123A (N.Y. 2023), at https://www.nysenate.gov/legislation/bills/2023/A4123/amendment/A.

[109] SEC "SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors" (Mar. 6, 2024), at https://www.sec.gov/news/press-release/2024-31.

such as Texas Senate Bill 13.[110] States often look to entities' public disclosures in making such determinations.[111]

6. While Republicans in Congress Have Demonstrated an Interest in Anti-ESG Policies, It Is Unlikely That There Will Be Federal Anti-ESG Policy Unless and Until There Is a Change in the Presidential Administration

Republicans have introduced several anti-ESG bills in Congress.[112] Beyond legislation, a Republican ESG Working Group in Congress published an interim report regarding efforts to "protect . . . investors from progressive activists" in June 2023[113] and the Republican-controlled House Financial Services Committee led an "ESG month" in July 2023 that involved several different hearings.[114] Most recently, Republican Chairman of the House Committee on Oversight and Accountability James Comer has raised questions concerning the ESG practices of asset managers and the potential application of federal banking laws to such entities.[115] Some members of Congress have also claimed that certain ESG practices may constitute an antitrust violation.[116]

Currently, opposition from the executive branch is stifling anti-ESG efforts in Congress. For example, in the summer of 2023, President Biden vetoed a

---

[110] S. 13 (Tex. 2021), at https://capitol.texas.gov/BillLookup/History.aspx?LegSess=87R&Bill=SB13.

[111] See West Va. Code Art. 1c, at https://code.wvlegislature.gov/12-1C/.

[112] Press release: "Committee Republicans Introduce Measures to Combat the Influence of ESG Initiatives in America's Financial System" (July 25, 2023), at https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408927.

[113] "Republican ESG Working Group Releases Interim Report" (June 23, 2023), at https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408886.

[114] Zachary Warmbrodt, Politico, "GOP rage tamed for House 'ESG month'" (July 10, 2023), at https://www.politico.com/newsletters/morning-money/2023/07/10/gop-rage-tamed-for-house-esg-month-00105368.

[115] Letter from Chairman of the House Committee on Oversight and Accountability James Comer to Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System (Feb. 26, 2024), at https://oversight.house.gov/wp-content/uploads/2024/02/022624-Van-Der-Weide-Federal-Reserve-letter.pdf; Representative Comer's concerns echo remarks from Republican-nominated FDIC Director Jonathan McKernan. "Remarks by Jonathan McKernan, Director, FDIC Board of Directors, at the Session on Financial Regulation at the Annual Meeting of the Association of American Law Schools" (Jan. 5, 2024), at https://www.fdic.gov/news/speeches/2024/spjan0524.html.

[116] "Grassley, Cotton, Colleagues Warn Law Firms About ESG Initiatives" (Nov. 11, 2022), at https://www.grassley.senate.gov/news/news-releases/grassley-cotton-colleagues-warn-law-firms-about-esg-initiatives.

Republican-led attempt to overturn a Department of Labor Rule permitting the consideration of ESG factors in investment decisions.[117] The rule has since been challenged in court.[118] Similarly, the OCC "Fair Access" rule, described above, was tabled during the transition to the Biden Administration in 2021. If President Biden is re-elected, the federal government will continue to resist anti-ESG initiatives, while advancing pro-ESG policies.

However, a change in administration could rapidly reverse the fortunes of anti-ESG policies at the federal level. Recently, former president Trump promised on the campaign trail that if re-elected, he would "place strong protections to stop banks and regulators from trying to de-bank you from your . . . your political beliefs, what they do."[119] These statements underscore the anti-ESG movement's traction in the past few years, and its potential for an even greater regulatory impact in the years ahead.

---

[117] Karin Rives, S&P Global, "Biden vetoes GOP-led effort to overturn Labor Department ESG rule" (Mar. 20, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/biden-vetoes-gop-led-effort-to-overturn-labor-department-esg-rule-74245723.

[118] Covington, "26 State Attorneys General Appeal Biden ESG Rule" (Jan. 19, 2024), at https://www.cov.com/en/news-and-insights/media-mentions/2024/01/26-state-attorneys-general-appeal-biden-esg-rule.

[119] Ja'han Jones, MSNBC, "Trump's rant about 'debanking' serves as a message to far-right extremists," (Jan. 18, 2024), at https://www.msnbc.com/the-reidout/reidout-blog/trump-speech-debank-extremists-jim-jordan-rcna134524; Lindsay Kornick, Fox News, "'SNL' mocked for their 'woke smugness' after claiming Trump made up the term 'de-banking,'" (Jan. 28, 2024), at https://www.msnbc.com/the-reidout/reidout-blog/trump-speech-debank-extremists-jim-jordan-rcna134524.

Fintech Corporations: Defining the Practice and Regulation of Innovative Financial Enterprises – Part II

By Lerong Lu*

The term "financial technology" (Fintech) has gained popularity across the globe. It has generated a lot of debate among financial lawyers, academics, policymakers, and the media. However, there is still disagreement regarding the precise definition of Fintech and the types of financial activities, institutions, and markets that the term actually covers. The purpose of this multi-part paper is to make the study of Fintech a distinctive academic discipline for banking law scholars, students, and practitioners. The first part, published in the May 2024 issue of The Banking Law Journal*, examined the nature and meaning of Fintech and considered how artificial intelligence, blockchain, cloud computing, big data, and e-commerce have been applied to or integrated with financial institutions and markets. This second part discusses the main corporate structures and business models of Fintech, and outlines common characteristics of Fintech businesses. Then, the third part of this paper, to be published in the next issue of* The Banking Law Journal, *puts forward a brand-new regulatory framework for Fintech consisting of five pillars for sound and effective governance of Fintech: corporate finance and securities regulation, corporate governance and ESG, regulatory sandbox, regulatory technology (RegTech), and the balanced regulatory strategy. This paper sheds light on the theory, practice, and regulation of innovative financial enterprises.*

III. THE FINTECH CORPORATION: BUSINESS STRUCTURES AND SPECIAL FEATURES

Fintech has been transforming every aspect of the financial system, including how consumers save, borrow, and invest money, as well as how institutions deliver their services. The diverse array of Fintech services has been provided by various types of financial institutions, ranging from Fintech start-ups to established financial groups and BigTech companies. This section discusses a number of Fintech corporations that offer innovative financial services and products and identifies their common features.

A. Fintech Start-Ups and Unicorns

We have seen Fintech corporations organized under different business models. First of all, a sizable portion of Fintech services have been provided by tech start-ups or brand-new Fintech companies that have no prior financial industry experience. The examples are Monzo, Starling Bank, LendingClub,

---

* Dr. Lerong Lu is Senior Lecturer in Law (Associate Professor) and Director of the LLM Law & Technology Programme at The Dickson Poon School of Law at King's College London in the United Kingdom. Dr. Lu may be contacted at lerong.lu@kcl.ac.uk.

Tide, Stripe, and Klarna. It is observed that most Fintech firms that operate today had been set up from scratch by entrepreneurs in the past two decades (2000-2020). Compared with established financial institutions, Fintech start-ups benefit from low-cost and efficient operation since they do not possess legacy IT systems and other heavy assets like a branch network and a large number of employees. Besides, in many jurisdictions, novel Fintech businesses are subject to lighter regulatory scrutiny or receive favourable policy supports, such as the regulatory sandbox regime or Fintech seed funds. This could be another advantage for new Fintech businesses, but it also brings extra risks due to the potential regulatory arbitrage problem. However, there are also clear drawbacks for Fintech companies, as they don't seem to have the scale, reputation, or distribution systems to compete with conventional financial giants.[1]

Numerous Fintech start-ups have utilized resources such as venture capital funding and proprietary technology to rapidly acquire significant market shares, leveraging online distribution channels to access millions of customers. A total of 2,693 mergers and acquisitions (M&A), private equity (PE), and venture capital (VC) transactions contributed to the $135.7 billion Fintech investments in 2019.[2] Some successful Fintech companies have become a so-called unicorn corporation, which means unlisted tech companies with a valuation of over $1 billion.[3] Only 0.07% of VC-backed technology start-ups have achieved the prestigious unicorn status.[4] There are variants of unicorn companies, which include decacorns with a valuation over $10 billion, and hectocorns with a valuation over $100 billion. As of March 2023, there were 1,207 unicorn companies globally with a total cumulative valuation of $3,776 billion.[5] Fintech companies comprise 258 (or 21%) of all unicorn companies, making it the largest industry in the global economy and a significant contributor to innovation and wealth creation. However, unicorns are geographically concen-

---

[1] Emma Dunkley, "Fintech Start-Ups Put Banks Under Pressure," The Financial Times, September 12, 2016, https://www.ft.com/content/ce8fa350-737f-11e6-bf48-b372cdb1043a.

[2] KPMG, "Pulse of Fintech H2 2019," February 2020, https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2020/02/pulse-of-fintech-h2-2019.pdf.

[3] The Economist, "Technology Companies: the Rise and Fall of the Unicorns," November 28, 2015, p. 57.

[4] Aileen Lee, "Welcome to the Unicorn Club: Learning from Billion-Dollar Start-Ups," TechCrunch, November 2, 2013, http://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/.

[5] CB Insights, "The Complete List of Unicorn Companies," http://www.cbinsights.com/research-unicorn-companies.

trated in a handful of countries, including the United States, China, India, the UK, Germany, France, Canada, Israel, and South Korea.

B. Existing Banking and Financial Institutions

Many existing financial institutions have been actively testing and launching Fintech products and services to sustain their competitiveness and market position. In January 2021, JPMorgan launched its digital-only consumer banking app in the UK by using the Chase brand, which employs incentives like 1% cashback, free overseas use of debit cards, and high interest rates on saving accounts to attract British consumers to try the new digital experience of banking.[6] Large commercial banks (e.g., HSBC, Barclays, Wells Fargo, Citibank, and ICBC), investment banks (e.g., Goldman Sachs, Morgan Stanley, Credit Suisse, and Deutsche Bank), insurance companies (e.g., Allianz, AXA, Ping An, Aviva, and Prudential), accounting firms (e.g., PwC, Deloitte, EY, and KPMG), and hedge funds are quickly embracing all sorts of technological innovations. With more capital, clients, talent, and other resources at their disposal, large financial firms could scale up and solidify their market domination within a short period of time. Even some second-tier banks and smaller financial institutions have been trying to launch their own Fintech products or platforms to attract customers. For example, the UK's Clydesdale Bank and Yorkshire Bank released a smart mobile banking app "B" which is able to learn the spending habits of its users automatically and offer tips to save money and make better budgets.[7]

In addition, Fintech services and products are sometimes provided by a joint venture or consortium between large financial institutions and new Fintech companies. In most cases, the former would provide financial resources and customer base, while the latter offers innovative technical solutions in financial services. Some incumbent banks have attempted to establish a cooperative relationship with Fintech start-ups, or even acquired certain stakes in them, in order to benefit from the rapid growth of Fintech industry. In 2015, the Spanish lender BBVA spent £45 million purchasing 29.5% of the shares in Atom Bank, an online-only lender in the UK.[8] In China, commercial banks are

---

[6] JPMorgan Chase, "JPMorgan Chase to Launch Digital Consumer Banking in the U.K.," January 27, 2021, https://www.jpmorganchase.com/news-stories/jpmorgan-chase-to-launch-digital-consumer-banking-in-the-uk.

[7] Rupert Jones, "The Digital Upstarts Offering App-Only Banking For Smartphone Users," The Guardian, May 14, 2016, https://www.theguardian.com/money/2016/may/14/digital-app-only-banking-smartphone.

[8] Martin Arnold and Emma Dunkley, "BBVA Enters UK With Atom Deal," The Financial Times, November 24, 2015, p. 17.

accelerating their collaboration or forming strategic partnership with Fintech companies, such as the alliance between ICBC and Alibaba's Ant Financial.[9] This kind of partnership normally creates a win-win situation for both traditional banks and Fintech companies as they share the growing market and industry profits on a mutually beneficial basis.

C. BigTech Corporations Offering Financial Services

BigTech companies worldwide are leveraging their technological prowess and extensive customer bases to enter the finance sector, generating a plethora of innovative Fintech products, services, and platforms. BigTech companies are skilled at constructing their services, products, and ecosystems utilising information technologies. Most U.S. BigTech companies like Alphabet, Amazon, Apple, and Meta, and Chinese BigTech firms like Alibaba and Tencent have long been involved in the financial services industry. Running their own financial services gives BigTech companies a significant advantage because they can quickly and thoroughly understand consumer demands thanks to their advanced analytics, network effects, as well as the valuable consumer data gathered in their core businesses, such as social media, telecommunications, internet search, and e-commerce.[10] BigTech might swiftly join the financial sector by using such knowledge, capacities, and strategies. The successful operation of Apple Pay and Google Pay has already demonstrated that BigTech companies are significantly more competent at running payment systems than traditional banks and payment operators. Additionally, Meta's Diem project, which serves as a model for future digital currency, has drawn a lot of media interest.[11]

BigTech companies have capitalized on what's known as the data-network-activities (DNA) loop to drive their businesses forward.[12] BigTech firms harness extensive consumer data for analytics, enabling the creation of enhanced services with specialized features. This diverse array of offerings is poised to

---

[9] Alibaba, "ICBC, Alibaba And Ant Financial Form Comprehensive Strategic Partnership Bringing Enhanced Fintech And Financial Services To Users," December 16, 2019, https://www.alibabagroup.com/en/news/press_pdf/p191216.pdf.

[10] Tobias Adrian, "BigTech in Financial Services," International Monetary Fund, June 16, 2021, https://www.imf.org/en/News/Articles/2021/06/16/sp061721-bigtech-in-financial-services.

[11] Hannah Murphy, "Facebook's Libra Currency To Launch Next Year In Limited Format," The Financial Times, November 27, 2020, https://www.ft.com/content/cfe4ca11-139a-4d4e-8a65-b3be3a0166be.

[12] Hyun Song Shin, "Big Tech In Finance: Opportunities And Risks," Bank for International Settlements, June 30, 2019, https://www.bis.org/speeches/sp190630b.pdf.

amplify network effects, drawing in more consumers and driving increased user engagement. More users will then generate more data, completing the self-reinforcing loop. BigTech's main business, however, is still in technology. Financial services make up a relatively small portion of their revenues, in contrast to Fintech companies that concentrate on the provision of financial services as their primary undertaking. Only 11.3% of BigTech's earnings, according to the Bank for International Settlements, came from financial services, whilst 46.2% went to information technology.[13] However, BigTech's market share in finance is increasing quickly, as by virtue of their size, resources, and organisational structure, so BigTech firms have a significant capacity to speed up the transition towards financial service provision.

D. Metaverse Platforms and Financial Services

The metaverse has surged in popularity within the commercial world in the 2020s. It refers to an imaginary version of the Internet that functions as a singular, all-encompassing, and interactive virtual universe, enabled by the use of virtual reality (VR) and augmented reality (AR) devices. In October 2021, Facebook changed its name to Meta because the social media behemoth thought that the Metaverse will be the upcoming revolution in social interaction and the replacement for mobile internet.[14] In 1992, science fiction author Neal Stevenson first used the phrase Metaverse to describe the 3D virtual world in his book "Snow Crash."[15] Metaverse, like the Internet, enables us to communicate with one another when we are not present in person and will bring us even closer to that experience.[16] The Metaverse movement is centered on the rapid progress of Web 3.0 technologies, which are at the forefront of a paradigm change in online commerce.[17] As Metaverse is a full-function virtual world, there will be the provision of a variety of financial services similar to that offered in the real world.

The recent time has witnessed financial institutions and Fintech platforms making strategies to embrace VR and Metaverse to improve operational efficiency and consumer experience. For example, VR training has been

---

13 Bank for International Settlements, "BIS Annual Economic Report," June 2019, p. 56, https://www.bis.org/publ/arpdf/ar2019e.pdf.

14 BBC, "Facebook Changes Its Name to Meta in Major Rebrand," October 28, 2021, https://www.bbc.co.uk/news/technology-59083601.

15 Neal Stevenson, Snow Crash (London: Penguin, 2011).

16 Meta, "What is the Metaverse?," https://about.meta.com/what-is-the-Metaverse/.

17 Jon M. Garon, "Legal Implications of a Ubiquitous Metaverse and a Web3 Future" (2022) 106 Marquette Law Review 163, 171.

introduced by the Bank of America for the first time in almost 4,300 financial centers across the United States.[18] A virtual banking environment is being used by 50,000 employees to practice a number of simple to complicated duties and simulate client interactions. South Korea's KB Kookmin Bank, to update the financial infrastructure in its Metaverse, created simulated financial towns, telecommuting centers, and virtual interaction areas.[19] The Fintech trading platform, eToro, introduced MetaverseLife as a smart portfolio with exposure to various Metaverse companies and platforms.[20] It is expected that consumers can access most financial services in Metaverse in the near future.

Non-fungible tokens (NFTs) are another area of Fintech application in Metaverse. NFTs are used to verify authenticity and ownership of digital assets in virtual worlds, which are special digital identifiers that cannot be duplicated, replaced, or divided.[21] In practice, NFTs are stored in a public ledger or blockchain using the same technology as cryptocurrencies. They can represent any virtual assets like artwork, GIF images, videos, music, collectibles, avatars, video game skins, and tweets. NFTs are well-liked in the digital art world because of their unique characteristics that enable online assets to have provable scarcity and unalterable ownership. NFTs are likely to have a large secondary market, as they can continue to be traded among collectors after being created by artists and internet users.[22] Every NFT has a provenance, allowing collectors to check for authenticity before making a purchase or placing a bid.

E. The Special Features of Fintech Corporations

Fintech not only provides consumers with more convenient and affordable financial services but also enhances efficiency and profitability for financial

---

[18] Bank of America, "Bank of America is First in Industry to Launch Virtual Reality Training Program in Nearly 4,300 Financial Centers," October 7, 2021, https://newsroom.bankofamerica.com/content/newsroom/press-releases/2021/10/bank-of-america-is-first-in-industry-to-launch-virtual-reality-t.html.

[19] McKinsey, "Value Creation In The Metaverse: The Real Business Of The Virtual World," June 2022, p. 45, https://www.mckinsey.com/~/media/mckinsey/business%20functions/marketing%20and%20sales/our%20insights/value%20creation%20in%20the%20metaverse/Value-creation-in-the-metaverse.pdf.

[20] eToro, "Invest in Virtual Worlds at MetaverseLife CopyPortfolio," https://www.etoro.com/smartportfolios/Metaverselife.

[21] Usman W Chohan, "Non-Fungible Tokens: Blockchains, Scarcity, and Value," Critical Blockchain Research Initiative Working Papers, March 24, 2021, http://dx.doi.org/10.2139/ssrn.3822743.

[22] Sotheby, "NFTs: Redefining Digital Ownership and Scarcity," April 6, 2021, https://www.sothebys.com/en/articles/nfts-redefining-digital-ownership-and-scarcity.

institutions. It typically embodies at least one of the following seven characteristics: innovation, disintermediation, automation, virtualisation, accessibility, customer centricity, and scalability.

Innovation

Innovation is the powerful delivery of creative ideas, which gives rise to new products, services, processes, and business models.[23] According to the perspectives of today's consumers, professionals, and investors, Fintech services and their providers must be innovative. As stated, innovation is a truly dynamic and constantly evolving process that never stops. Even the most ground-breaking financial innovations from twenty years ago, such as internet banking and online brokerage, are no longer viewed as revolutionary by today's consumers. Most people take such digital services for granted. Similarly, the greatest financial innovations from today, like cryptocurrencies and mobile payments, will soon become the norm for tomorrow's economy. Additionally, innovation must add value or increase the efficiency of providing financial services. It cannot be pursued solely for its own sake. Thanks to the thriving Fintech sector, both established institutions and start-ups put a lot of work into fusing the latest technologies like cloud computing, big data, blockchain, and artificial intelligence with financial practices to generate real impacts.

Disintermediation

The majority of financial transactions need to go through specific financial institutions that function as intermediaries. The heavy reliance on financial intermediaries often leads to a situation where some traditional institutions like banks and brokers have obtained a dominant or even monopolistic market status. In contrast, financial disintermediation aims to remove banks, brokers, and any other third parties from the financial transaction process and interest relationships, enabling individuals and companies to conduct transactions or enter into investment agreements with each other directly.[24] For example, online P2P lending platforms, as a pure information exchange, directly match the investment need of savers with the capital demand of individual consumers and smaller businesses. Otherwise, savers would have to deposit their money into banks at first, and then banks would make loans from the pooled funds to any borrowers later. Also, cryptocurrencies tend to disintermediate traditional

---

[23] Marc de Jong, Nathan Marston, and Erik Roth, "The Eight Essentials Of Innovation," McKinsey Quarterly, April 1, 2015, at https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-eight-essentials-of-innovation.

[24] Lerong Lu, "Solving the SME Financing Puzzle in the UK: Has Online P2P Lending Got the Midas Touch?" (2018) 33 Journal of International Banking Law and Regulation 449, 454.

monetary and payment transactions by removing central banks and other authorities in the process of issuing and transferring money. Recently, financial activities based on decentralized finance (DeFi) have gained great popularity as they rely on distributed ledgers and smart contracts to offer financial services on a peer-to-peer basis, which are accessible to anyone as long as they have the internet connection.[25]

Automation

The level of automation in the financial sector has significantly increased due to the broad application of Fintech and AI. The financial services industry is currently experiencing a progressive replacement of human occupations with increasing amounts of work being done by computers, machines, and robots. For example, algorithmic trading is rising rapidly among investment banks, hedge funds, and professional traders, as it refers to the process of using computers to execute securities transaction orders that involve automated or pre-programmed instructions to take into account variables like price, volume, and timing.[26] Moreover, most credit checks against potential borrowers are now performed by computers that have access to databases of credit information and use their computational capacity to analyse the big data to reach a decision in a matter of seconds. It is not only the quantity of automation but also its quality is quickly improving. There is little doubt that the more intelligent machines enabled by data technologies and AI could assist financial institutions in making more accurate and efficient decisions when it comes to assessing the risks associated with lending and investing, as well as determining insurance premiums.

Virtualization

Traditional finance relies on the branch network to reach clients and provide services. Major banks like HSBC and Barclays have thousands of physical branches on the high streets of most towns, in addition to their headquarters and regional offices. However, a large number of Fintech service providers have limited or even no physical presence, as they could only be accessed by financial consumers via smartphone apps or online websites. Due to the lack of infrastructure legacies, many Fintech start-ups use the asset-light strategy. Online-based challenger banks like Monzo and Revolut are good examples representing the trend of virtualisation of financial services, as they do not

---

[25] Coinbase, "What is DeFi?," https://www.coinbase.com/learn/crypto-basics/what-is-defi.

[26] IG, "Algorithmic Trading," https://www.ig.com/uk/trading-platforms/algorithmic-trading.

possess any brick-and-mortar branches as traditional banks do.[27] The full digital presence has brought significant benefits in two aspects. One the one hand, it cuts the hefty costs of running the branch network, and on the other, virtual banks have no geographical boundaries for their business operation, so they can expand explosively within a short period of time.[28] In addition, all the virtual currencies (cryptocurrencies), as their name suggests, are fully digitalized and virtual, even the crypto exchanges themselves. The same is true for utilising traditional currency like the U.S. dollar, Chinese yuan, and British pound at a time when more and more people are turning to mobile payment systems like Apple Pay and Alipay, which are fostering the development of a cashless society. The trend of virtualisation of finance has been accelerated by the Covid-19 pandemic, as more people work, play, and shop online.

Accessibility

Most Fintech services are considered easily accessible and affordable for financial consumers, due to their online presence and low-cost business strategy. It echoes the widely held policy objective of financial inclusion, which calls for ensuring that all people and organisations have equal access to practical and reasonably priced financial products and services that satisfy their basic needs, including payments, transactions, savings, credit, and insurance.[29] It is obvious that the timely and economical provision of financial services is contributing to a more sustainable global economy. At present, billions of population around the world are still excluded from the mainstream financial system, lacking access to the essential banking and payment services. Kenya's M-Pesa, as Africa's largest mobile money service and leading Fintech platform, offers an effective solution for unbanked population to use basic financial services including depositing, withdrawing, paying, and transferring money on a mobile device.[30] Clearly, with the aid of modern technologies, Fintech is able to provide more accessible and inexpensive financial services, benefiting consumers and businesses in both developed countries and emerging economies.

Customer Centricity

In order to provide a positive customer experience, customer-focused businesses put customers at the center of their organisational structure and

---

[27] Lerong Lu, "Financial Technology and Challenger Banks in the UK: Gap Fillers or Real Challengers?" (2017) 32 Journal of International Banking Law and Regulation 273, 277.

[28] Ibid.

[29] World Bank, "Financial Inclusion Overview," https://www.worldbank.org/en/topic/financialinclusion/overview.

[30] Vodafone, "M-Pesa," https://www.vodafone.com/about-vodafone/what-we-do/consumer-products-and-services/m-pesa.

corporate culture.[31] This increases customer loyalty and promotes company expansion. Compared with conventional financial institutions, Fintech companies tend to focus more on the real demands and experience of customers, based on which they design the products and ways of delivering services. It often leads to the simple and easy-to-use interface of Fintech apps like Monzo and Alipay where users could easily identify and access various functions by fingertip. The simplicity and convenience of Fintech services is unimaginable in the past when we need to queue in a bank branch before talking to any staff members to convey our demands and then being served. Moreover, the majority of Fintech products and services are created so as to address specific consumer needs or pain points. For example, the undesirability of carrying heavy wallets to hold banknotes and plastic cards when consumers go out led to the creation of mobile payment tools. Besides, Fintech companies are more customer centric because they value customers' engagement and feedback. Many of them have online community forums to collect costumers' suggestions and advice to improve product design and service quality.[32]

Scalability

The term "scalability" refers to an organisation's capacity to expand rapidly and respond to a growing workload by adding or efficiently utilising resources.[33] Fintech companies are agile in a sense that they, as the challengers and latecomers, have to react to the market demand quickly and precisely in order to survive and prosper. Most Fintech businesses are capable of scaling up their business operation within a short time, due to their simple, straightforward, and low-cost business models based on online distribution channels. The small capital requirement, coupled with the wide reach of internet and mobile network, allows them to acquire millions of customers shortly. For instance, launched in 2012, the crypto exchange platform Coinbase today has 103 million verified customers who rely on the platform to transmit, utilize, and invest in cryptocurrencies.[34] In addition, it collaborates with 14,500 institutions and 245,000 ecosystem partners in more than 100 nations.

---

[31] Denise Lee Yohn, "6 Ways to Build a Customer-Centric Culture," Harvard Business Review, October 2, 2018, https://hbr.org/2018/10/6-ways-to-build-a-customer-centric-culture.

[32] For example, see Monzo Community Forum, accessed June 1, 2023, https://community.monzo.com/; and Trading 212 Community, accessed June 1, 2023, https://community.trading212.com/.

[33] Deloitte, "The Fintech Dilemma: When To Scale Up Your Business?," https://www2.deloitte.com/uk/en/pages/financial-services/articles/fintech-dilemma-when-to-scale-up-your-business.html.

[34] Coinbase, "About - Coinbase," https://www.coinbase.com/about.

In contrast, it took traditional stock exchanges (such as New York Stock Exchange, London Stock Exchange, and Shanghai Stock Exchange) several decades to establish their customer base and global reach. Apparently, Fintech companies are good at building ecosystems with business partners, clients, and even regulatory agencies. Some Fintech firms like PayPal and Stripe have adopted the application programming interface (API) system which opens their digital platforms to appropriate third parties who can offer a variety of financial services to users. It is likely to speed up market penetration, increase competitiveness, and enrich customer experience by offering more consumer choices. Fintech ecosystems are powerful as they embrace openness and accessibility, which partly explains why they have grown so quickly over the past decade.

* * *

Editor's note: The third part of this article will be published in the next issue of *The Banking Law Journal.*

It's Not Your Fault, But It May Be Your Problem: Increasing Regulatory Scrutiny on Vendor Cybersecurity Risks

By Kayleigh S. Shuler*

In this article, the author explains how a vendor's data incident can be nearly as time-consuming, costly and reputationally damaging as an internal incident.

For organizations that watched (or worse, lived through) the fallout from recent large-scale vendor incidents, the prospect of learning that a trusted vendor has experienced a data incident is almost as distressing as the idea of the organization experiencing an incident itself.

That's because a vendor incident – meaning an incident that occurs at or is otherwise caused by a third-party service provider – can be nearly as time-consuming, costly and reputationally damaging as an internal incident.

CHALLENGES OF VENDOR INCIDENTS

Vendor incidents can come with all the usual challenges of any security event – operational disruptions, public relations pressures and concerns about data compromise – but often come with the added element of being "in the dark" until a vendor decides to share details about what happened and what they're doing about it.

Additionally, depending on the vendor's level of cooperation, the ultimate responsibility to notify individuals may land on the company, even though it is not at fault.

All the while, an individual who learned that their data may have been compromised will likely point the finger back at whomever they entrusted their data to, regardless of whether that company is truly where the breach occurred.

INCREASING REGULATORY ATTENTION

Regulatory bodies, particularly those in the financial industry, are increasingly taking note of this type of incident and raising the level of attention they pay to vendor management. Questions that often come after a company notifies regulators of a vendor incident include:

- What level of diligence did your organization conduct before trusting a vendor with data?
- If the vendor made security-related promises – such as to delete data

* The author, an attorney with Polsinelli PC, may be contacted at kshuler@polsinelli.com.

after contract termination – did your organization confirm those promises were kept?

- Why was a vendor holding so much data for so long?

In 2023, we saw regulatory efforts to gain more insight into these relationships and the risks they pose in the National Credit Union Administration's (NCUA) approval of a final rule that requires a federally insured credit union to report "reportable cyber incidents" to the NCUA as soon as possible, and in no event later than 72 hours after the credit union reasonably believes that it has experienced a reportable cyber incident.[1] Under the rule, the NCUA suggests that if a third party reports experiencing a breach of a credit union's sensitive member information, that credit union likely needs to report to incident to NCUA.[2] Credit unions have apparently heeded that advice. According to NCUA Chairman Todd M. Harper, "[i]n the first 30 days after the rule became effective, the NCUA received 146 incident reports, more than it had received in total in the previous year. More than 60 percent of these incident reports involve third-party service providers and credit union service organizations."[3]

Regulators overseeing banks have so far approached the issue from a slightly different and less direct direction but with a similar result. In guidance issued June 6, 2023, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency (the Banking Agencies) provided detailed guidance to banking organizations on vendor management throughout the life cycle of a vendor relationship. This guidance included oversight and accountability procedures for the life of the relationship.[4] This guidance added to an existing rule issued from the Banking Agencies which requires bank service providers to notify bank customers as soon as possible upon experiencing certain types of incidents.

---

[1] 12 CFR § 748.1(c).

[2] See Appendix A: Examples of Substantial Incidents that Likely Would Qualify as Reportable Cyber Incidents, available at https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/cyber-incident-notification-requirements/appendix-a.

[3] See testimony of NCUA Chairman Todd M. Harper Before the Senate Banking, Housing, and Urban Affairs Committee, available at https://ncua.gov/newsroom/testimony/2023/ncua-chairman-todd-m-harpers-written-testimony-senate-banking-housing-and-urban-affairs-committee#:~:text=In%20the%20first%2030%20days,union%20service%20organizations%20(CUSOs).

[4] See Interagency Guidance on Third-Party Relationships: Risk Management, available at https://www.govinfo.gov/content/pkg/FR-2023-06-09/pdf/2023-12340.pdf.

LOOKING AHEAD

Looking ahead, we can expect continued vendor incident scrutiny on both vendors and the organizations they serve. For its part, the NCUA is currently seeking congressional authority to directly examine third-party vendors, which it cannot do under existing law.

In testimony before Congress, the NCUA has stated that its inability to directly regulate credit union providers "creates a regulatory blind spot"[5] and that without this power, "NCUA is unable to effectively protect credit unions and their members."[6] If Congress agrees, the NCUA may be given authority to demand information from vendors or impose corrective action plans on them, which vendors can largely ignore under current law.

Given the frequency with which vendor incidents are occurring and the increased regulatory interest in them, organizations should think through what they can do to position themselves for a strong response. For instance, consider: If a regulator inquired about how we vetted a vendor, are we comfortable with our answer? Is our vendor management program robust? For those on the vendor side of the coin, the challenges are similar, but the key questions are different. Here, consider: if customers impose additional security vetting, are we prepared to provide the accurate and digestible information they'll need to feel comfortable partnering with us?

In all cases, increasing regulatory attention to vendor security should be top of mind.

---

[5] See testimony of NCUA Director of Office of Financial Technology and Access Charles A. Vice before the Subcommittee on Digital Assets, Financial Technology and Inclusion.

[6] Harper testimony, supra note 3.

Looking Ahead to the Federal Trade Commission's Implementation of the Data Breach Notification Rule for Nonbanking Financial Institutions

By Alexander D. Boyd and Colin H. Black[*]

In this article, the authors discuss a new rule requiring nonbanking financial institutions to notify the Federal Trade Commission within 30 days of discovering a data breach involving the nonpublic personal information of at least 500 consumers.

Nonbanking "financial institutions" now must notify the Federal Trade Commission (FTC) within 30 days of discovering a data breach involving the nonpublic personal information of at least 500 consumers. These covered organizations can include a wide variety of companies that engage in financial activities but that are not directly regulated by federal banking regulators, including automobile dealerships, higher educational institutions participating in federal student financial aid programs, mortgage lenders or brokers, tax preparation firms, travel agencies, and others.

These organizations are already required to implement certain information security protections pursuant to the FTC's Safeguards Rule.[1] The FTC's new data breach notification requirement will provide the FTC with a critical tool to ensure that organizations are properly safeguarding consumer data.

BACKGROUND

All fifty states have enacted some form of a data breach notification law. Certain industries are also subject to data breach notification obligations at the federal level. The Gramm-Leach-Bliley Act (GLBA) imposes certain privacy and data security obligations on covered "financial institutions."[2] Under the GLBA, financial institutions are broadly defined to include any institutions engaging in activities that are financial in nature or incidental to such financial activity.[3] For banking (typically depository) financial institutions, the GLBA provides enforcement authority to the federal banking regulators (the Federal Deposit Insurance Corporation, Federal Reserve, Office of the Comptroller of

[*] The authors, attorneys with Polsinelli PC, may be contacted at aboyd@polsinelli.com and cblack@polsinelli.com, respectively.

[1] 16 C.F.R. Part 314.

[2] 15 U.S.C. §§ 6801-6809.

[3] 15 U.S.C. § 6801(3).

the Currency, and National Credit Union Administration). For all other types of financial institutions, the GLBA provides enforcement authority to the FTC.[4]

Under the FTC's existing Safeguards Rule, covered financial institutions must develop, implement and maintain an information security program that includes nine specific elements.[5] On October 27, 2023, the FTC adopted an amendment to the FTC's Safeguards Rule that will increase the number of organizations subject to federal data breach reporting requirements, including many organizations that may not realize they are considered a "financial institution" under the GLBA's broad definition.

REQUIREMENTS UNDER THE AMENDED SAFEGUARDS RULE

The amended Safeguards Rule requires financial institutions to report any instance of the unauthorized acquisition of unencrypted customer information of at least 500 consumers to the FTC as soon as possible but in no event later than thirty days following discovery of the incident. The rule broadly defines customer information to include any nonpublic personal information about a customer of a financial institution, whether in paper, electronic or other form.[6] This includes any information provided by the customer in order to obtain a financial product, information about a customer resulting from any transaction involving a financial product or service, and any other information obtained about the customer in connection with providing the financial service.

The notice to the FTC must include:

(1) The name and contact information of the reporting financial institution;

(2) A description of the types of information that were involved in the notification event;

(3) The date or date range of the notification event (if it is possible to determine);

(4) The number of consumers affected;

(5) A general description of the event; and

(6) If applicable, whether any law enforcement official has provided the institution with a written determination that notifying the public of a breach would impede a criminal investigation.

---

[4] 15 U.S.C. § 6805.

[5] 16 C.F.R. § 14.4.

[6] 16 C.F.R. § 314.2.

ANTICIPATING FTC INVESTIGATIONS AND PUBLIC DISCLOSURE UNDER THE NEW RULE

Once an organization notifies the FTC of a data breach under the new rule, it will then face risks associated with the public disclosure of the notice and a potential FTC investigation. The FTC intends to publicly post the data breach notices it receives.[7] These postings will increase the risk of litigation and media attention arising out of the data incident.

The FTC is also likely to initiate investigations into many of the reported breaches.[8] Consistent with how the FTC has investigated prior data security incidents and consistent with how other federal regulators investigate reported incidents, reporting organizations should expect the FTC to conduct a three-pronged inquiry following a data breach report.

First, the FTC will likely request information about how the organization responded to the incident, including how it conducted its investigation, how it ensured that its systems were secure, and whether and how it notified potentially affected individuals.

Second, the FTC is likely to seek information about the organization's underlying information security program and compliance with the FTC's Safeguards Rule.

Finally, the FTC may seek information about the organization's overall data privacy compliance program under the FTC's jurisdiction to investigate and prohibit unfair or deceptive acts or practices in commerce.[9] The FTC's inquiry into these areas can be quite detailed.

STEPS TO TAKE

As a threshold matter, all organizations should determine whether they are subject to the FTC's Safeguards Rule well in advance of any data security incident. The new data breach notification requirement is only one part of the more comprehensive set of data security requirements under the Safeguards Rule. Covered organizations must implement an information security program that contains nine specific elements. This new reporting rule provides the FTC with a new method to identify and investigate financial institutions that may not be compliant with the Safeguards Rule.

Covered organizations should ensure that their data security incident response plans address the new rule by incorporating the definitions and

[7] 88 Fed. Reg. 77,506 (Nov. 13, 2023).

[8] 88 Fed. Reg. 77,501 (Nov. 13, 2023).

[9] 15 U.S.C. 45.

reporting time frames under the FTC rule and other applicable law. As with any external notice regarding a data security incident, notices to the FTC should be timely, factual and accurate. The organization should identify the person or team who will be responsible for leading the organization's incident response and ensuring that regulators are notified in accordance with applicable law.

The organization should distribute the updated incident response plan to all individuals who may be required to execute on the plan in both physical and digital formats. Once the plan is adopted, organizations should ensure that the plan is routinely tested to identify potential gaps and to increase the effectiveness of the response plan under an actual crisis.

U.S. Office of the Comptroller of the Currency Begins to Revamp Bank Merger Review Process

By Michael D. Lewis and Matthew S. Katz*

In this article, the authors review a proposal by the U.S. Office of the Comptroller of the Currency that is a significant step in amending the Bank Merger Act framework.

The U.S. Office of the Comptroller of the Currency (OCC) has proposed changes to its regulations for evaluating transactions under the Bank Merger Act (BMA) and adoption of a policy statement that outlines the principles and factors the OCC considers in reviewing applications for approval of transactions subject to the BMA (together, the Proposal).[1] The Proposal was released in conjunction with a speech by Acting Comptroller Michael Hsu that makes valuable contributions to a discussion of the macro environment for the banking system in the United States and how bank merger-and-acquisition (M&A) activity and the associated regulatory process should relate to this broader context.[2]

The Proposal follows a 2021 executive order regarding economic competition as well as a series of subsequent regulatory symposia, speeches, and requests for information regarding the BMA (and bank M&A more specifically). It is a critical early step in a larger interagency process to revisit the framework for evaluating bank M&A transactions, which is likely to have a meaningful impact on the bank M&A environment in the coming years.

REGULATORY CHANGES

The Proposal includes two main changes to the OCC regulations implementing the BMA.

First, it eliminates expedited review of certain applications, a procedure under which such applications are deemed approved 15 days after the end of the associated comment period (if the review period is not otherwise extended). The Proposal indicates that expedited review is inappropriate given the

[*] The authors, attorneys with Sidley Austin LLP, may be contacted at michael.lewis@sidley.com and matthew.katz@sidley.com, respectively.

[1] Business Combinations Under the Bank Merger Act, 89 Fed. Reg. 10010 (Feb. 13, 2024).

[2] Michael J. Hsu, Acting Comptroller of the Currency, What Should the U.S. Banking System Look Like? Diverse, Dynamic, and Balanced, Address at the University of Michigan School of Business (Jan. 29, 2024).

significance of the types of transactions reviewable under the BMA and that all such transactions should be adjudicated by the OCC rather than approved based on the passage of time.

Second, the Proposal also eliminates the OCC's streamlined version of the BMA application, usable in certain specified transactions. The Proposal suggests this is being done for similar reasons – that the presence of a complete application would provide a fuller record for the OCC to review and adjudicate significant transactions and that the OCC could tailor the required information in its discretion if appropriate.

POLICY STATEMENT

The policy statement included in the Proposal is meant to provide greater clarity to financial institutions and the public regarding how the OCC will evaluate transactions subject to the BMA. Transactions subject to the BMA include bank mergers as well as certain kinds of asset purchases, such as the acquisition of substantially all of the assets and liabilities of another bank or the assumption of any deposit liabilities of another bank. Issues addressed by the policy statement include the general principles that the OCC will follow in reviewing BMA applications as well as how the OCC will analyze specific factors it is required by statute to address when reviewing an application. A number of these key issues addressed in the policy statement are outlined below.

General Principles of OCC Review

The policy statement sets out 13 factors generally consistent with approvals of the corresponding transactions and six factors that would raise supervisory or regulatory concerns (and thus are inconsistent with approvals). No single factor is necessarily dispositive, although institutions should carefully evaluate each of these factors in considering potential transactions.

The factors consistent with approvals are the following:

1. The acquirer is and the post-merger resulting institution will be well capitalized.
2. The resulting institution will have total assets less than $50 billion.
3. The acquirer has a Community Reinvestment Act (CRA) rating of outstanding or satisfactory.
4. The acquirer has composite and management ratings of 1 or 2 under the Uniform Financial Institution Ratings System (UFIRS) or ROCA rating system.
5. The acquirer has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System, if applicable.

6. The acquirer has no open formal or informal enforcement actions.
7. The acquirer has no open or pending fair lending actions, including referrals or notifications to other agencies.
8. The acquirer is effective in combatting money laundering activities.
9. The target's combined total assets are less than or equal to 50% of acquirer's total assets.
10. The target is an eligible depository institution (as defined by OCC regulation).
11. The proposed transaction clearly would not have a significant adverse effect on competition.
12. The OCC has not identified a significant legal or policy issue.
13. No adverse comment letter from the public has raised a significant CRA or consumer compliance concern.

The factors inconsistent with approvals are the following:

1. The acquirer has a CRA rating of "needs to improve" or substantial noncompliance;
2. The acquirer has a consumer compliance rating of 3 or worse;
3. The acquirer has UFIRS or ROCA composite or management ratings of 3 or worse, or the most recent report of examination otherwise indicates that the acquirer is not financially sound or well managed;
4. The acquirer is a global systemically important banking organization (GSIB) or subsidiary thereof;
5. The acquirer has open or pending Bank Secrecy Act/anti-money-laundering enforcement or fair lending actions, including referrals or notifications to other agencies; or
6. The acquirer has failed to adopt, implement, and adhere to all the corrective actions required by a formal enforcement action in a timely manner, or multiple enforcement actions have been executed or are outstanding against the acquirer during a three-year period.

Financial Stability

The BMA requires the OCC to consider the risk to the stability of the United States banking or financial system when reviewing an application. In doing so, the OCC will apply a balancing test, weighing different factors as well as the risk posed by both the approval or disapproval of the proposed transaction. Factors to be considered include the size of the resulting institution, the availability of alternatives following the transaction, the complexity of the resulting institution, the contagion risks posed by the resulting institution, and whether the resulting institution can be readily resolved in the event of distress.

Financial and Managerial Resources and Future Prospects

The BMA requires the OCC to consider the managerial resources, financial resources, and future prospects of the combining and the resulting institutions when reviewing an application. The OCC will consider relevant factors both independently as well as in concert, given their interrelation. These factors include the size, complexity, and risk profile of the combining and resulting institutions; the supervisory record of the acquirer; the adequacy of the resulting institution's capital, liquidity, management, and earnings prospects; and pertinent regulatory exam ratings and findings.

Convenience and Needs

The OCC considers the probable effects of a transaction subject to the BMA on the community to be served by the resulting institution. This includes looking at plans to close or consolidate branches or otherwise limit services, credit availability for different types of community needs (home loans, farm loans, etc.), changes in the institution's workforce, and community investment initiatives.

Public Comments and Meetings

Transactions subject to the BMA generally require a 30-day comment period following publication of the notice of the proposed transaction. While the BMA does not require the OCC to hold meetings or hearings, the OCC may elect to do so based on weighing the public's interest in the transaction with the value or harm of a public meeting to the decision-making process.

THREE KEY TAKEAWAYS

First, if adopted as proposed, the Proposal seems to make the environment for M&A involving nationally chartered banks and savings associations generally more favorable for community banks and smaller regional banks (under $50 billion in total assets) but more challenging for GSIBs and their subsidiaries. Moreover, the Proposal could introduce greater complexity to the review of mergers of equals as compared to the acquisition by a larger institution of a clearly smaller one. However, under the Proposal, no single factor (such as size) is necessarily dispositive. As such, all banks will still want to carefully evaluate each potential transaction before determining whether to proceed.

Second, Acting Comptroller Hsu's speech seems to divide potential transactions subject to BMA review into three general categories:

- Those that are easy to approve because the depository institutions involved are model banks and the transaction has clear benefits. This means that the parties and the transaction tend to satisfy most or all of the 13 factors consistent with approvals and avoid the six factors that are inconsistent with approvals.

- Those that seem to be especially challenging for a relatively clear reason or reasons, which are likely to result in greater scrutiny and a greater likelihood of disapproval; and
- Those banks that fall in neither of the prior two and thus are in the middle. Knowing which category a proposed transaction is likely to fit into will be essential to assessing both the likelihood and, importantly, the timing of needed regulatory approvals.

Third, the Proposal is an important step forward in greater transparency in the bank M&A environment.

However, there is still a great deal of work to be done by the banking agencies and other government agencies with regard to the interagency review of the evaluation of bank M&A more generally. Given the OCC's jurisdiction, the Proposal cannot address either state-chartered banks or any bank holding companies. That said, the Proposal is still a significant step in amending the BMA framework and a hint of what is to come.

The Benefits of Term Debt Tranches in Fund Finance Products, and What to Consider When Utilizing Term Debt

By Kiel A. Bowen, Mark C. Dempsey and Andrew L. Hogan*

In this article, the authors explore how term debt tranches can bolster lending capacity and accommodate debt issuances.

With new banking rules on the horizon for financial institutions, lenders are looking for new strategies to bolster lending capacity and accommodate debt issuances. One such option is term debt. This article explores the promising prospect – for lenders and borrowers alike – of utilizing term debt tranches to attract new lenders into the existing market and provide even more flexibility to existing collateral structures.

BACKGROUND

A persistent liquidity crunch has prompted both borrowers and arrangers to earnestly explore novel avenues for financial flexibility, thereby increasing the demand for new lender participants in the fund finance market. Moreover, Basel III endgame and related rules will require financial institutions to comply with stricter capital and loss-absorbing capacity requirements, in turn imposing a need for lenders to adapt by adopting novel strategies to bolster lending capacity and accommodate debt issuances. The 2023 banking market disruption further prompted new entrants to the fund finance market.

WHY IS TERM DEBT AN ATTRACTIVE SOLUTION?

In an environment primarily consisting of one-year maturities, banks have an annual opportunity to reprice subscription facilities to follow market-driven interest rate adjustments. While term debt does not need a longer tenor, longer-maturity term debt can allow borrowers to hedge this risk by locking in either a fixed-term rate or floating rate with certainty that the debt will not mature in the short term. Even in one-year term facilities, term debt can allow borrowers access to non-traditional liquidity providers. Often, term lenders cannot offer revolvers due to operational reasons or return-on-investment targets. The funding sources for non-traditional lenders may be unable to accommodate funding borrowers on the shorter two- or three-day timelines that traditional banks offer. Additionally, the unused commitment of a

* The authors, attorneys with Mayer Brown, may be contacted at kbowen@mayerbrown.com, mdempsey@mayerbrown.com and mdempsey@mayerbrown.com, respectively.

revolving facility will drag down the return that non-traditional lenders seek. A term loan to the borrower solves these issues for all parties involved.

Depending on a fund's structure, term debt can have multiple uses. At the special purpose vehicle (SPV) level, term debt can allow a fund to leverage a particular investment or warehouse a continuation fund. A term loan to the fund itself can allow for longer-term, portfolio-wide leverage. And at the investor level, term debt can be used to make catch-up payments for later fund closings as well as solve investor-specific structuring complications. At each of these levels, an arranger has an opportunity to create a lasting relationship between their borrower client and lending partners. However, there are certainly unique issues to consider in any term fund finance structure, especially if term and revolving components are provided by different lenders.

WHAT SHOULD BORROWERS AND ARRANGERS CONSIDER WHEN EXTENDING TERM DEBT TO SUBSCRIPTION CREDIT FACILITIES

Agent Selection

One of the initial considerations for borrowers and arrangers is selecting the agent. When term and revolving lenders are not the same entity, the revolver will often be provided by a traditional bank while non-bank lenders will fund the term tranche. Although a bank lender may have the capability to serve as the agent (which the term lender may not), the revolving tranche may mature before the term tranche, potentially leading the revolving lender to manage a facility in which they have no exposure. Parties should assess whether employing a third-party agent makes sense, allowing revolving lenders to exit upon maturity without burdening term lenders with agent responsibilities.

Friction Among Lenders

When revolving and term lenders are distinct entities, borrowers and arrangers should consider potential sources of friction. For instance, the term tranche typically carries a higher yield than the revolver, leading the term lender to request that the term tranche be advanced first. The term tranche may also feature a prepayment penalty and follow a different payment schedule. However, there are certain instances where the term lenders will want to be repaid higher than usual in the payment waterfall.

The payment waterfall, especially during a default scenario, will likely be a highly negotiated provision. Parties will need to determine the payment order of principal, interest, and fees of both debt tranches along with the borrower's needs for capital (ranging from already committed investments to residual at the end of the waterfall). The lenders should consider whether certain lenders have higher priority with respect to certain collateral or if one lender is wholly subordinated to the other. If there are differing maturities, a shorter-dated revolving lender may have different concerns in collateral sales than a longer-dated term lender so the parties will need to consider who can make decisions on the sale of collateral and when these decisions can be made.

Finally, the lenders may have different perspectives on smaller items, such as voting rights over amendments or certain negative covenants, that should either be made by one or all lenders.

Collateral

On any longer-dated maturity for a loan provided to a fund, lenders must consider the changing collateral. A fund's uncalled capital commitments will naturally reduce over time as the value of the fund's investments increases. If the term tranche is secured by uncalled capital, term lenders should plan for the gradual reduction in uncalled capital commitments through scheduled amortization of the term loans. If the facility is secured by investments, standard financial covenants should be included to ensure adequate collateral coverage.

Rating

Insurance company lenders have been increasingly active in the fund finance space. They are well-positioned to provide a term tranche but will often need structural accommodations. Primarily, insurance companies will look to have the term tranche rated by a rating agency. This requires cooperation by the borrower and arranger to provide the rating agency with the necessary documentation.

Alignment and Misalignment with the Borrower

Given the potential for a longer-dated maturity, it is critical to understand the alignment and misalignment of interest between the lenders and the borrower. To the extent the borrower is at an investor level in the fund structure, all parties must consider when the borrower may be deemed a defaulting partner by the underlying fund. Lenders rely on the value of investments for repayment, making fund-initiated default remedies detrimental to lender interests.

Additionally, term lenders may rely on regularly scheduled amortization payments, necessitating an understanding of the expected distribution of cash proceeds from investments and how much control the underlying fund and its affiliates have over those distributions.

If the borrower is a fund, lenders must comprehend how the fund's needs will evolve over time. This involves discussions about the broader debt requirements of the fund structure, delving into investments, and understanding how the fund will manage its portfolio. As the borrower will engage with the facility over an extended period, it may request greater flexibility to make distributions, permission to incur additional debt, and relief from certain covenants during a ramp-up period.

If the debt is utilized at the SPV level beneath the fund to warehouse an investment, lenders should be mindful of the concentration risk posed by that investment. Covenants should be considered on investment-level debt, and a comprehensive understanding of the investment details is essential.

CONCLUSION

As the fund finance market continues to evolve, we expect to see more term debt and remain optimistic about its use going forward. Although term debt arrangements in the fund finance market can address liquidity challenges, interest rate uncertainties, and shorter maturities, implementing term fund finance structures also requires careful consideration of factors like agent selection, lender friction, payment waterfall negotiations, and understanding the interests of all parties involved.

New York Department of Financial Services Adopts Final Guidance on Assessment of Character and Fitness of Directors, Senior Officers and Managers

By Jarryd E. Anderson, Jessica S. Carey and Roberto J. Gonzalez*

In this article, the authors discuss guidance issued recently by the New York State Department of Financial Services that suggests that, going forward, the department will be more carefully scrutinizing character and fitness policies and procedures and their ability to guard against "compromised" directors and officers, as well as ordinary conflicts of interest.

The New York State Department of Financial Services (NYDFS) has issued final guidance (the Guidance) for most institutions holding a license from the NYDFS[1] (Covered Institutions) setting out NYDFS's expectation that Covered Institutions engage in rigorous character and fitness assessments of directors, senior officers and managers, both at onboarding and on an ongoing basis.[2] The Guidance reflects an ongoing effort by policymakers and regulators to raise corporate governance and oversight standards following the bank failures of 2023, including NYDFS's closure of Signature Bank in March 2023.

The Guidance states that NYDFS expects Covered Institutions to update their vetting frameworks for directors, senior officers and managers to require ongoing vetting and to define warning signs or indicators that warrant additional scrutiny, such as prior service at institutions that have been subject to regulatory actions or proceedings. The Guidance is substantially similar to NYDFS's proposed guidance issued on June 30, 2023, but clarifies the non-binding legal nature of the Guidance in response to public comments highlighting that issue.[3]

---

* The authors, attorneys with Paul, Weiss, Rifkind, Wharton & Garrison LLP, may be contacted at janderson@paulweiss.com, jcarey@paulweiss.com and rgonzalez@paulweiss.com, respectively.

[1] "Covered Institutions" are defined in the Guidance and discussed more below.

[2] N.Y. Dep't of Fin. Servs., Industry Letter: Guidance on Assessment of the Character and Fitness of Directors, Senior Officers, and Managers (2024), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20240122_guidance_on_assessment (the Guidance).

[3] N.Y. Dep't of Fin. Servs., Proposed Guidance on Assessment of the Character and Fitness of Directors, Senior Officers and Managers (2023), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20230509_guidance_assessment_fitness.

KEY FEATURES OF THE GUIDANCE

Covered Institutions

The Guidance applies to the following Covered Institutions:

(i) New York state-regulated banking organizations (i.e., banks, trust companies, private bankers, savings banks, safe deposit companies, savings and loan associations, credit unions, investment companies, and branches, agencies and representative offices of foreign banking organizations licensed by NYDFS);

(ii) Non-depository financial institutions licensed or chartered under the New York Banking Law except for mortgage loan originators;[4] and

(iii) Institutions licensed under Part 200 of the Regulations of the Superintendent of Financial Services (i.e., virtual currency institutions).[5]

Designated Persons

The Guidance is applicable to each member of the board of directors, board of trustees, and/or board of managers, or similar body as applicable and each senior officer (each, a Designated Person). While the Guidance does list some positions that are presumed to be "senior officers," the definition of a senior officer may extend beyond such titles or positions and "refers to every officer who participates or has authority to participate (other than in the capacity of a director) in major policy-making functions of a Covered Institution." The Guidance clarifies that an individual holding any one of several specified titles[6] at a Covered Institution is considered a senior officer, unless, "by resolution of the board of directors or by the bylaws of the Covered Institution, such individual is excluded from participation in major policy-making functions and that individual in fact does not participate therein." The definition of a senior officer is similar to definitions utilized by the federal banking agencies in their reviews of changes in senior executive officers.[7]

Policies and Procedures for Character and Fitness Assessments

NYDFS states that the assessment of the character and fitness of Designated Persons is important in protecting the safety and soundness of a Covered

---

[4] NYDFS stated that the Guidance does not apply to mortgage originators because "the substantive concerns reflected in this Guidance are already addressed through the licensing and renewal process [of Mortgage loan originators] and there are no other Designated Persons for which a regular vetting and assessment process would be required."

[5] See 23 NYCRR § 200.

[6] The specified titles include "[a]ny chief executive officer, chief financial officer, chief operations officer, chief compliance officer, chief legal officer, chief risk officer, president, senior executive vice president, executive vice president, secretary of the board of directors, or treasurer."

[7] See, e.g., 12 C.F.R. § 5.51(c)(4).

Institution because "a compromised director, officer, or manager can threaten an organization's safety and soundness at any time during that individual's service."[8] Covered Institutions are expected to develop, implement and maintain policies and procedures for vetting character and fitness of the Designated Persons in the onboarding process and on an ongoing basis. The vetting process should include consistent, ongoing methods to ensure that no intervening circumstance – such as a conflict of interest or a material change – would make the Designated Person unfit for their role.

Covered Institutions should also respond promptly to intervening circumstances that would make a Designated Person's continuation in their role improper. If material adverse findings regarding a Designated Person result in the person's removal or transfer or to modifications to their current functions, the institution is expected to promptly notify the NYDFS.

Vetting policies and procedures should define the sensitive issues, warning signs and other indicators that would warrant extra scrutiny, such as service at a prior institution subject to a regulatory action such as an enforcement action, receivership or conservatorship. Although the Guidance does not dictate any specific frequency or type of assessment, the Guidance advises that each Covered Institution's framework should be "consistent with the risk profile of [its] operations,"[9] and provides an Appendix[10] with questions that are drawn from best practices that Covered Institutions may consider utilizing in developing their own vetting frameworks.

Covered Institutions are expected to review the materials that they generate in the character and fitness vetting process and relay the findings to their board of directors (or equivalent) and chief compliance officer (or equivalent). Covered Institutions are also expected to maintain a copy of their vetting policy for NYDFS examiners to review to confirm that the Covered Institution is in compliance with the Guidance.

CONCLUSION

While most Covered Institutions will already have some policies or procedures in place to evaluate the fitness of their directors and executive officers, at many Covered Institutions, current policies and procedures may focus on the

[8] See Guidance ¶ 1.

[9] See Guidance ¶ 10.

[10] See Guidance Appendix: Suggested Questions to Facilitate Initial and Ongoing Assessment of Designated Persons' Character and Fitness. Available at https://www.dfs.ny.gov/industry_guidance/industry_letters/il20240122_guidance_on_assessment. The Guidance Appendix is published at the end of this article.

initial onboarding of key personnel or apply to a smaller universe of individuals. Thus, the Guidance's recommendation that Covered Institutions conduct ongoing assessments of personnel defined as senior officers may require review and revision of existing practices in this area.

The Guidance also makes clear that it should not be viewed as limiting the scope of any other law or regulation. For instance, in what may be an unlikely hypothetical, if there were a conflict between the Guidance and a privacy law (e.g., the Gramm-Leach-Bliley Act or the Health Insurance Portability and Accountability Act), the privacy law would take precedence. The issuance of the Guidance suggests that, going forward, NYDFS examiners will be more carefully scrutinizing character and fitness policies and procedures and their ability to guard against "compromised" directors and officers, as well as ordinary conflicts of interest.

* * *

Appendix from NYDFS Guidance on Assessment of Character and Fitness of Directors, Senior Officers and Managers

Suggested Questions to Facilitate Initial and Ongoing Assessment of Designated Persons' Character and Fitness

1. Acknowledge that you have reviewed and understand the following policies of [Covered Institution] and provide in a separate attachment evidence of any documented exceptions to compliance with these policies:
    - Gifts and Loan Policy
    - Insider Trading Policy
    - Electronics Communications Policy
    - Social Media Policy
    - Data Protection Policy
    - Records Management Policy
    - Conflict of Interest Policy
    - Health and Safety Policies
    - Corporate Opportunity Policy
    - Harassment and Discrimination Policies
    - Outside Business Policy
    - Political Contributions Policy
    - Personal Trading Policy

- Outside Lobbying Activity Policy
- [Other applicable policies]

2. For ongoing assessment, to the best of your knowledge, have you been in compliance with all above-listed policies [during [year(s)], and made all disclosures required, including seeking exceptions from these policies as appropriate, and being granted such exceptions?
3. During [year(s)], have you been charged with, indicted for, or convicted of a crime, and/or pleaded *nolo contendere* in any criminal matter (including, but not limited to, driving under the influence, reckless driving and/or disorderly conduct)?
4. Have you or any financial institution with which you are, or were, associated with, been sanctioned and/or censured in any way by a banking or securities regulator during [year(s)], including any regulatory sanction, consent order, enforcement order, supervisory agreement, civil monetary penalty or other administrative penalties?
5. Have you been the subject of any professional disciplinary actions, denied a license, and/or had a license suspended or revoked during [year(s)] (e.g., a governmental or professional licensing organization), excepting banking and securities regulators referenced in Question 4?
6. Please describe in a separate attachment, any civil litigation, investigation or sanction – including but not limited to any regulatory sanction, consent order/agreement, enforcement order/agreement, or other administrative findings or penalties – in which you have, to your knowledge, been named or have otherwise become involved in your professional capacity, or which have been initiated against a prior employer in connection with your responsibilities in that position, in the preceding ten (10) years.
7. Have you ever been dismissed or asked to resign from past employment, including a less than honorable discharge from military service?
8. Have you been involved in any of the following filings where the filing was denied, disapproved, withdrawn or otherwise returned without favorable action by a federal or state regulatory authority or a self-regulatory organization?
    - A charter or license application, a depository institution holding company application or an application for federal deposit insurance, in which you were listed as an organizer, director, senior executive officer, or a person that would own or control (either individually or as a member of a group) 10 percent or more of

any class of voting securities or other voting equity interest of the institution, or similar position

- A merger application in which you were listed as a director, senior executive officer or similar position
- A notice of change in director or senior executive officer, or similar form, in which you were listed as a director, senior executive officer or similar position
- A notice of change in control for a depository institution or other company, or a similar form, in which you were listed (either individually or as a member of a group) as an acquirer or transferee
- Any other application, notice or other regulatory or administrative request which was filed with a federal or state regulatory authority or a self-regulatory organization in which you were listed in some capacity

9. Has anyone in your immediate family or an individual living in your household worked for the Covered Institution or an affiliate in [year(s)]? If so, please state their name and their relationship to you. "Immediate family" means the individual's children, parents, siblings, spouse or partner.
10. Have you or an immediate family member started or continued an outside business relationship with an auditor of [Covered Institution] during [year(s)]?
11. Please describe in a separate attachment all indebtedness to [Covered Institution] or an affiliate that you have incurred [during the past year / since your previous report] (excluding indebtedness associated with a general-purpose credit card), and the balance outstanding of all such indebtedness to [Covered Institution] or an affiliate at the end of [year].
12. Please describe in a separate attachment any lobbying activities in which you have been engaged in your personal capacity during [year(s)] and whether you were registered as a lobbyist in any jurisdiction during [year(s)].
13. Please describe in a separate attachment any litigation (unless described above) or bankruptcy proceedings of which you have been a part during [year(s)] and provide copies of all relevant documents.
14. Do you owe outstanding child support in connection with any

unemancipated child(ren)?

15. Please describe in a separate attachment all settlements of litigation (threatened or actual) brought against you in your personal or a professional capacity during [year(s)] and provide copies of all relevant documents.

16. Have you or any company with which you are associated or were associated with during [year(s)]:
    - Filed a petition under any chapter of the Bankruptcy Code or had an involuntary bankruptcy petition filed against you or the company?
    - Defaulted on a loan or financial obligation of any sort, whether as obligor, cosigner or guarantor?
    - Forfeited property in full or partial satisfaction of any financial obligation?
    - Had any liens or other judgments filed against you?
    - Had wages or income garnished for any reason?
    - Failed or refused to pay any outstanding judgments?

17. Have you filed/paid all of your required income and other taxes for [year(s)]?

18. Please list in a separate attachment all companies (whether publicly traded or not) and any organizations (including not-for-profit and/or charitable) of which you have been a member of the board of directors or an executive officer during [year(s)].

19. Have you been a senior officer or a board member at a financial institution that filed for reorganization or bankruptcy; became subject to a receivership or conservatorship proceeding; became subject to a resolution or liquidation proceeding; had its license, charter, or registration surrendered or revoked; received financial assistance from a federal or state agency or instrumentality (e.g., FDIC); merged with or been acquired by an institution that received financial assistance from a federal or state agency of instrumentality in connection with the transaction; or otherwise failed or ended business operations?

20. Please disclose all compensation received during [year(s)], beyond amounts paid to you as compensation by [Covered Institution].

Declined: Consumer Financial Protection Bureau Proposes Rule to Limit Nonsufficient Funds Fees

By Andrew E. Bigart, Max Bonici, Michael M. Aphibal, David A. McGee and Brandon Wong*

In this article, the authors review a rule proposed by the Consumer Financial Protection Bureau prohibiting financial institutions from charging nonsufficient fund fees on all "instantaneously or near-instantaneously" declined transactions.

One week after the Consumer Financial Protection Bureau (CFPB) published its proposed rule restricting overdraft fees,[1] the CFPB proposed yet another rule prohibiting nonsufficient funds fees (NSF fees) on transactions like declined debit card purchases and attempted ATM withdrawals, among others.[2]

This is part of an ongoing CFPB effort to curb what it views are "junk fees." Although often discussed together, NSF fees are different from overdraft fees because NSF fees are charged only after a declined transaction. Using the CFPB's abusiveness authority, the proposed rule would prohibit fees for declining a transaction where the financial institution is able to decline the transaction in real time or within seconds after the payment request is initiated. Unlike the proposed overdraft rule, the proposed NSF fees rule would apply broadly to financial institutions, not merely to financial institutions with assets over a certain threshold.

AFFECTED COMPANIES

The proposed rule would apply to "financial institutions," as defined in Regulation E, which includes banks, savings associations, credit unions, or any other person that directly or indirectly holds a consumer account or that issues an access device to a consumer to provide electronic fund transfer services.[3] The proposed rule would also cover "accounts," as defined in Regulation E, such as demand deposit (checking), savings, or other consumer asset accounts held

---

* The authors, attorneys with Venable LLP, may be contacted at aebigart@venable.com, mbonici@venable.com, mmaphibal@venable.com, and damcgee@venable.com respectively. Glen O. Hisani assisted in the preparation of this article.

[1] Overdraft Lending: Very Large Financial Institutions, 89 Fed. Reg. 13852 (proposed Feb. 23, 2024).

[2] Fees for Instantaneously Declined Transactions, 89 Fed. Reg. 6031 (proposed Jan. 31, 2024).

[3] 12 C.F.R. § 1005.2(i) (2023).

directly or indirectly by a financial institution and established primarily for personal, family, or household purposes.[4] Accounts held by a financial institution under a bona fide trust agreement, profit-sharing and pension accounts established under a trust agreement, escrow accounts, and accounts for accumulating funds to purchase U.S. savings bonds would be excluded from coverage, as these accounts are not "accounts" under the definition in Regulation E.

COVERED TRANSACTIONS

The proposed rule would prohibit NSF fees on all "instantaneously or near-instantaneously" declined transactions. The CFPB explained this happens "when the transaction is processed in real time and there is no significant perceptible delay to the consumer when attempting the transaction."[5] For example, NSF fees due to declinations on ATMs or point-of-sale (POS) debit transactions would be prohibited.[6]

In contrast, transactions that are declined or rejected hours or days after the attempt because of insufficient funds would not be covered. The proposed rule would not include, for example, NSF fees on checks and ACH transactions, since these payment methods must go through a clearing process, which typically takes one to two days.[7]

ABUSIVENESS AUTHORITY

The CFPB relies on its Dodd-Frank Act authority[8] to declare certain acts or practices as "abusive" to promulgate this proposed rule. Under that authority, an act or practice can be abusive if a person takes unreasonable advantage of the lack of understanding on the part of a consumer of the material costs, risks, or conditions of the product or service.

In the proposed rule, the CFPB states that NSF fees are abusive in covered transactions because "consumers charged NSF fees on covered transactions would lack understanding of the material risks, costs, or conditions of their account at the time they are initiating covered transactions."[9] In the CFPB's

---

[4] Id. § 1005.2(b).

[5] Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6037.

[6] Press Release, Consumer Fin. Prot. Bureau, CFPB Proposes Rule to Stop New Junk Fees on Bank Accounts (Jan. 24, 2024), https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-rule-to-stop-new-junk-fees-on-bank-accounts/.

[7] Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6037.

[8] 12 U.S.C. § 5531 (2022).

[9] Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6041.

view, this is true even if consumers are given fee disclosures when a transaction is attempted. Note that Regulation DD[10] and Regulation E[11] already require fee disclosures upon account opening and before the consumer first uses electronic fund transfer services.

The CFPB characterizes NSF fees as something "paid without any service being received," which appears to be a newly articulated criterion for abusiveness.[12] Per the CFPB, "if a transaction entails material risks or costs and consumers derive minimal or no benefit from the transaction, it is generally reasonable to conclude that consumers who nonetheless went ahead with the transaction did not understand the material risks, costs or the conditions giving rise to those risks or costs."[13] Put another way, if "consumers would be paying something or taking a risk but receiving nothing in return[,]" the CFPB might consider that an abusive practice.[14]

The CFPB has gone after similar concerns in the past,[15] using its unfairness authority to fine companies for charging consumers for services without providing the benefit of those services, such as for identity protection or credit monitoring services. Perhaps the CFPB decided to use its abusiveness authority instead of its unfairness authority in this rulemaking because, under *abusiveness*, the CFPB need not analyze whether NSF fees are "reasonably avoidable" by the consumer, as might be required under the unfairness definition.[16] The CFPB may also be using this rulemaking to restate how its abusiveness authority should be applied, departing from how it had been applied in prior rulemakings under previous leadership.[17]

---

10 12 C.F.R. § 1030.4(b)(4) (2023).

11 Id. § 1005.7(b)(5).

12 Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6041.

13 Id. at 6042.

14 Id.

15 E.g., Press Release, Consumer Fin. Prot. Bureau, CFPB Takes Action Against Companies For Unfair Billing Of Credit Card Add-On Products And Services (July 1, 2015), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-companies-for-unfair-billing-of-credit-card-add-on-products-and-services/.

16 See 12 U.S.C. § 5531 (2022).

17 See Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6039 (discussing how previous rulemakings conflated the lack-of-understanding and reasonable-avoidability standards of the *unfairness* and *abusiveness* definitions).

CLOSING A POTENTIAL LOOPHOLE?

It is no coincidence that the CFPB chose to publish this proposed rule one week after it published its proposed overdraft rule. In the NSF fee proposed rule, the CFPB explained that part of the reasoning for the proposal was prophylactic.

According to the CFPB, NSF fees are rarely charged on ATM or POS debit transaction declinations, although the CFPB is also aware that NSF fees are currently being charged in connection with prepaid accounts and transactions declined at ATMs that are outside a depository institution's ATM network.

Yet, the CFPB states that it is proposing the rule primarily as a preventive measure. "Financial institutions have ongoing incentives to generate revenue, and NSF fees may become increasingly appealing as a revenue source in the absence of this proposal."[18] The CFPB fears that if the overdraft proposed rule is finalized and it reduces overdraft fee revenue, companies might shift to NSF fees instead.

CONCLUSION

Financial institutions that could be subject to either the overdraft proposed rule or this NSF fee proposed rule will need to consider how the rules may affect their business and their ability to provide financial products and services to consumers.

Additionally, because the NSF fee proposed rule would apply only to some transactions and not others, companies will need to ensure their systems can properly distinguish between declinations occurring from a covered transaction and those from non-covered transactions.

---

[18] Id. at 6038.