Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

Barnett Sivon & Natter P.C.
ATTORNEYS at LAW
WASHINGTON, DC

Six Observations on Financial Regulation*†

Jim Sivon

February, 2018

I have six observations on the outlook for financial regulation. They may be summarized as follows: All Rise; All Square; It Will Come Down to Deference; The Tailor Rule; The Other CRA; and What about Treasury?

All Rise is a reference to the Supreme Court and the two cases involving the Consumer Financial Protection Bureau (CFPB) that eventually could find their way to the Court: the *PHH* case and *English v. Trump.* Both cases present interesting questions.

The *PHH* case involves a constitutional challenge to the structure of CFPB, and to CFPB's interpretation of the Real Estate Settlements Procedures Act (RESPA). This past week, PHH lost on its constitutional challenge, but won on its RESPA challenge. PHH may not appeal the constitutional issue, but if it does, it is not clear who will defend CFPB before the Court. The Dodd-Frank Act provides that CFPB cannot represent itself before the Supreme Court unless the Justice Department agrees, and Justice is unlikely to permit CFPB to defend itself. So if there is an appeal, it will be interesting to see who defends the CFPB.

English v. Trump involves a dispute over what law governs the selection of the acting director of the CFPB: the Dodd-Frank Act or the Federal Vacancies Reform Act. So far, a federal District Court has said that the Federal Vacancies Reform Act prevails. However, if the case reaches the Supreme Court, we could see a different result. In a 2016 case involving the Federal Vacancies Reform Act and the National Labor Relations Board, the court said that the general rule under that Federal Vacancies Reform Act is for the first deputy of an agency to serve in the absence of the head of the agency. In other words, if that general rule were applied in the case of the CFPB, Ms. English is the rightful replacement for Director Cordray, not OMB Director Mulvaney. Additionally, in a concurring opinion, Justice Thomas questioned the constitutionality of the Federal Vacancies Reform Act. Thus, there may be some interest on the part of the Court to take this case—if it gets that far. The case is currently on expedited appeal to the Federal Court of Appeals for the District of Columbia.

All Square refers to the Square's application to the Federal Deposit Insurance Corporation (FDIC) for deposit insurance for an industrial loan company (ILC). While ILCs can take limited deposits and engage

*Based upon my remarks at the 2018 Smoke Tree Conference.

†The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

in commercial lending, they are not "banks" for purposes of the Bank Holding Company Act. This means that the parent of an ILC may engage in any commercial activity, and is not limited to activities that are closely related to banking or financial in nature. The fact that Square is pursuing an ILC charter suggests that its current—or future—activities exceed those permissible for a bank holding company. If that is the case, Congress the approval of the Square application could trigger a Congressional reaction.

Over the past 60 years, whenever we have a convergence of banking and commerce, Congress has stepped in to stop it. The 1956 Bank Holding Company Act (BHCA) was a response to Transamerica's acquisition of a bank, tuna canning company and other businesses. The 1970 amendments to the BHCA plugged the so-called "one-bank" loophole in the BHCA, which permitted a company to avoid the application of the BHCA simply by owning one bank, not multiple banks. In 1987 Congress closed the so-called "non-bank bank" loophole, which permitted commercial companies to own banks that engaged in commercial lending. In 1999, Congress it closed the so-called "unitary thrift" loophole, which permitted unitary savings and loan holding companies to engage in commercial activities. And, most recently, in 2010, as part of the Dodd Frank Act, Congress imposed a five-year moratorium on deposit insurance for ILCs. In each case, there was a vigorous debate over grandfathering for companies. This suggests that anyone thinking about deposit insurance for an ILC should put an application into the FDIC sooner rather than later.

It will come down to deference refers to the potential for the Office of the Comptroller of the Currency (OCC) to issue a so-called "FinTech" charter. When OCC first announced that it was contemplating charters for FinTechs, I was quoted in the *American Banker* to the effect that the agency was on solid legal ground. Frankly, having looked at this question a little more, I find that the OCC's authority to charter a bank that does not accept deposit insurance is not so clear cut. Therefore, I suspect the legal challenges over this question will boil down to how much deference a court will give to OCC's interpretation of its own statute.

T**he Tailor Rule** is not a reference to the Federal Reserve Board's monetary policy, but to the outlook for the Board to "tailor" some of the rules put in place following the financial crisis. Actually, the Board already has taken a number of steps in this direction with adjustments to the capital planning rule for regional banks, and proposals to modify corporate governance requirements and to enhance disclosures surrounding the supervisory stress tests. We can anticipate more. The new Vice Chairman for Supervision, Randal Quarles, gave a speech a couple weeks ago in which he announced plans to review a number of current rules. Chairman Powell also has announced the formation of a special unit within the agency to conduct cost/benefit analyses on regulations.

The Other CRA refers to the Congressional Review Act and Congress's ability to overturn regulations. As long as the Republicans control Congress and the White House, this authority will continue to serve as a check on new financial regulations. It also applies to agency guidance as well as formal rules. Some members of Congress have signaled that they could raise a CRA challenge to the guidance on leveraged lending issued by the banking agencies, and CFPB's guidance on indirect auto lending.

Finally, **What about Treasury?** refers to Treasury's role in financial policy. The agency has produced a series of reports on financial policy, and is expected to release some additional recommendations on FinTech and the Community Reinvestment Act. These reports are a blueprint for change. However, Treasury does not have independent authority to implement the recommendations. They must be implemented by the federal banking agencies or Congress. Thus, it remains to be seen what will happen with these proposals.

Jim Sivon is a partner with the law firm of ***Barnett Sivon & Natter, P.C.***