CLEARY GOTTLIEB

ALERT MEMORANDUM

November 12, 2020

Financial Institution Regulation under President Biden: Key Areas to Watch

Following Vice President Joe Biden's apparent victory last weekend, attention has now turned to the transition and implications of a change in administration.

The pandemic and related economic downturn will guide the Biden Administration's immediate priorities for the financial sector, resulting in a focus on economic relief and stimulus, consumer protection and attention to any signs of financial instability. Given these and other priorities, and the relatively modest changes in financial regulation under the Trump Administration, regulatory reform is not likely to be a major area of focus in the early period of the administration. Gridlock in Congress also means that the existing regulatory architecture will remain intact in the short term. The most significant policymaking is likely to occur at the agencies.

A Republican-controlled Senate may result in moderate appointees to lead the Treasury Department and the financial regulatory agencies, although progressives will push hard for nominees reflecting the views of Senators Warren and Sanders. President Biden is also likely to minimize appointees with ties to Wall Street. Achieving racial and gender diversity, including in the key financial posts, is an announced goal of his administration.

Policy goals embraced by the Democratic Party are expected to feature in the agencies' regulatory and supervisory agendas, including a focus on reducing economic inequality, achieving racial justice and addressing climate change. Other current areas of focus will likely carry over into the Biden Administration, including robust enforcement related to anti-money laundering, market or consumer abuse, and other compliance matters. Addressing technological innovation will no doubt continue to be a priority, with perhaps greater emphasis on access to affordable financial services among underserved populations. Progressive concerns about the size of the largest financial institutions may generate greater scrutiny of large mergers or acquisitions, although changes to the statutory or regulatory framework in this regard seem unlikely.

This alert memorandum outlines key areas to watch for our financial institution clients. Please click here for our initial analysis of how the Biden presidency is likely to reshape the broader corporate landscape in areas such as the SEC's regulatory and enforcement focus, corporate governance, mergers and acquisitions, executive compensation and tax.

Leadership Changes at the Agencies

Personnel changes are likely to be the most significant driver of the Biden Administration's policy agenda over time. A full transition will not happen quickly, given the time required to fill positions and the fact that many Trump appointees have a year or more remaining in their terms.

Many agency principals and deputies are likely to be drawn from Obama-era personnel, and to reflect diversity in race, gender and background. Many can be expected to have limited or no Wall Street ties. With the Senate expected to remain in Republican hands, appointees with more moderate views are more likely to be confirmed. We expect the Treasury Secretary, Comptroller of the Currency and CFPB Director to be replaced expeditiously, while we anticipate slower turnover at the other Agencies. All of these positions are subject to Senate confirmation. The appendix to this memo provides a graphic summary of the anticipated leadership changes.

— *Treasury*: Secretary Mnuchin is expected to be replaced immediately. Federal Reserve Governor Brainard is frequently mentioned as a likely potential replacement.

— *OCC*: Acting Comptroller Brooks has not been confirmed. He is removable at will and his position is likely to be filled promptly on an acting basis, which would not require Senate confirmation.

— *CFPB*: While Director Kraninger's term does not end until December 2023, she is removable at will.

— *Federal Reserve*:

- Chair Powell's term ends in February 2022. President-elect Biden will have the ability to designate a new Chair from among the Governors, but it is possible that he will re-appoint Powell as Chair. This would be in keeping with historical practice for first-term Federal Reserve Chairs (with the exception of Chair Yellen, whom President Trump replaced after his election). Chair Powell has built relationships with both sides of the aisle, and the President may place value in continuity in dealing with the economic consequences of the pandemic.
- Vice Chair for Supervision Quarles could remain in that post until the expiration of his term as Vice Chair in October 2021, or the new Administration could seek to install a new supervision Vice Chair immediately. Vice Chair Quarles' term as a Governor does not expire until January 2032, but it appears unlikely that the Vice Chair would remain on the Board of Governors unless he remains Vice Chair.
- President-elect Biden may also enter office with two current vacancies to fill if current Trump nominees are not confirmed, and potentially three if he nominates Governor Brainard as Treasury Secretary and she is confirmed.

— *FDIC*:

- Chairman McWilliams' term as Chair expires in June 2023. She has stated her intent to serve the remainder of her term, although if she does so she would likely be in the minority for most of that period.
- The two *ex officio* FDIC directors (the Comptroller of the Currency and CFPB Director) are expected to be replaced quickly, at least on an acting basis, while President-elect Biden potentially can nominate two additional candidates because there is currently one vacant seat and Director Gruenberg is currently serving past the expiration of his term.
- If Chairman McWilliams remains, the currently vacant seat will likely be filled by a Republican because the Comptroller and the CFPB Director would be Democratic appointees and no more than three FDIC board members may be members of the same political party.

— *SEC:* Chairman Clayton could depart prior to the expiration of his term in June 2021. The four other commissioners' terms expire on a staggered basis from 2022-2025.

— *CFTC:* Chairman Tarbert could depart during transition or later in 2021, prior to the expiration of his term in 2024. Commissioner Quintenz has already announced his intention to step down. The Chairman's seat is expected to be filled by a Democrat, which could be one of the existing Democratic Commissioners, Behnam or Berkovitz (in which case another Democrat would still be appointed), while Quintenz's seat is expected to be filled by a Republican, because no more than three commissioners may be members of the same political party. The terms of the commissioners expire on a staggered basis from 2021-2023.

Policy Priorities

Pandemic response will be the top priority; financial regulatory agenda items—most notably racial equality and climate change—are likely to be implemented incrementally.

— The Administration will prioritize a fiscal response to the pandemic-induced economic crisis, pushing prudential regulation changes further down on the agenda. The new administration is likely to continue to look to banking organizations as a means of delivering public assistance, consistent with the framework of the CARES Act programs and facilities.

— The transition team for Biden has identified four priority areas: COVID-19, economic recovery, racial inequality and climate change. While effects of COVID-19 and the economic recovery on financial institutions will be economically significant, the other two policy goals are also likely to have significant implications for the operations and business strategies of financial institutions:

- *Racial inequality* priorities have multiple dimensions for financial institutions: (i) strengthening the Federal Reserve's focus on racial economic gaps through its existing unemployment mandate, (ii) appointing diverse Agency principals and deputies, (iii) more stringent regulation of bank practices that have disparate impact on women and communities of color and (iv) supporting minority-owned banks and community development financial institutions.
- *Climate change* considerations will likely be manifested in a focus on: (i) adequacy and standardization of climate-related financial disclosures, (ii) encouraging banks to use climate change as a factor in underwriting criteria, (iii) incorporating climate change considerations into risk weight calibrations under the capital rules, (iv) modifying supervisory stress testing to incorporate climate-related risks and (v) managing systemic as well as sector risk caused by climate change.

We expect the current rulebook to remain generally intact, with only modest modifications and a continued focus on supervision and enforcement.

— Anticipated Republican control of the Senate makes the Congressional Review Act essentially unavailable to overturn any final rules transmitted to Congress in the prior 60 legislative days. Agency notice and comment rulemaking would therefore be required to modify rules finalized during the Trump Administration. Large scale modification (or overturning) of recent rulemakings appears unlikely.

— Nevertheless, we expect that the following Trump-era rules are likely targets for modification or roll-back:

- *Banking:* (i) the OCC's "true lender" rule, (ii) the OCC's Community Reinvestment Act rule, (iii) the CFPB's payday lending rule and (iv) the CFPB's debt collection rule.
- *Securities and Derivatives:* (i) the CFTC's cross-border rule, (ii) the CFTC's swap dealer capital rule, (iii) the CFTC's position limits rule, (iv) the interagency non-cleared swap margin rule (particularly with regard to interaffiliate swap margin), (v) the SEC's Regulation BI and (vi) the SEC's rule on regulation for derivatives used by registered funds.

— The core elements of the Trump Administration's relatively modest bank regulatory reforms appear likely to remain intact, at this early stage.

- The *tailoring framework* enjoyed bipartisan support, and many of the changes were mandated by Congress. Wholesale and unilateral changes driven by the Agencies would be challenging to implement, and congressional oversight may create disincentives to pursue changes through regulation.
- *Volcker Rule* modifications require consensus by five agencies, some of which may be run by Trump appointees for another year or more. After ten years of nearly constant rulemaking through multiple administrations, the Agencies may collectively believe the time has come to put (or leave) pencils down.

— Two pieces of unfinished business on the Federal Reserve's rulemaking agenda appear likely to gain momentum:

- A *real-time payments system* has been embraced by the President-elect's transition team as helping to reduce racial inequality. This initiative is already being developed by the Federal Reserve and enjoys support among the current Governors.
- A *standardized liquidity requirement for branches and agencies of foreign banking organizations* may become more likely with potential changes in the composition of the Board and the possibility that Governor Brainard (an important proponent) could become Treasury Secretary. However, whether the United States would adopt a branch liquidity requirement before the Financial Stability Board considers an international standard remains unclear.

— *Dividend and stock buyback restrictions* may become more commonly used tools in capital planning and stress testing, while stress testing scenarios could be used as a tool to increase stress capital buffers (and therefore effective risk-based capital requirements) through more punitive assumptions or sector- and climate-specific risks. A change in leadership could also support new attention to the ways in which stress testing assumptions effectively increase the costs of providing certain types of financial services to underserved populations, including minority communities.

— *Enforcement* in areas including anti-money laundering, sanctions, market and consumer abuse, internal controls and cybersecurity remained robust during the Trump Administration and is likely to continue.

- *Banking:* We expect that the shift in priorities from prudential issues to consumer issues will be reflected in enforcement as well, particularly in the areas of fair lending, risk management programs, and internal controls. We expect a reinvigorated CFPB to adopt a more muscular enforcement program.
- *Securities & Derivatives:* We expect the SEC to shift its focus to conduct involving financial institutions and Wall Street more generally, in addition to continued focus on "Main Street" fraud with identifiable investor-victims. We also expect heightened enforcement of Title VII rules by the CFTC, including disclosure and reporting requirements, in addition to continued focus on market manipulation, especially spoofing.

Mergers and Acquisitions Outlook

While Democratic appointees are likely to view large financial institution combinations with greater skepticism, there is unlikely to be a significant practical impact on bank mergers and acquisitions.

— Federal deposit cap constraints, as well as acquisition size limitations in the Dodd-Frank Act, may make it difficult for the largest U.S. banking organizations to enter into large strategic transactions. On the other hand, further statutory restrictions on size or activities of banking organizations (e.g., 21st Century Glass-Steagall), while promoted by progressives, seem unlikely to pass Congress.

— The Federal Reserve could begin applying stricter review of proposed mergers and acquisitions involving banking organizations under the "financial stability factor" adopted in the Dodd-Frank Act. In the months immediately prior to the election, the Federal Reserve approved sizable acquisitions by firms in the highest categories of the tailoring framework, and concern about the size and effects of these acquisitions has been strong in the Democratic Party.

— The Federal Reserve could look to other tools in its existing toolbox to revamp its review of acquisition activity, including potentially (i) less flexible determinations of whether a transaction may increase *competition or efficiencies*; and (ii) more policy-oriented determinations of *public convenience*, including incorporating racial equality considerations in this review.

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Appendix

FEDERAL RESERVE BOARD

Chair Powell

Chair Term Ends: February 2022
Term Ends: February 2028

Vice Chair Clarida

Term Ends: January 2022

Vice Chair Quarles

Vice Chair Term Ends: October 2021
Term Ends: January 2032

Governor Brainard

Term Ends: January 2026

Governor Bowman

Term Ends: January 2034

Vacant

Vacant

FEDERAL DEPOSIT INSURANCE CORPORATION

Chair McWilliams

Chair Term Ends: June 2023
Term Ends: January 2024

Acting Comptroller Brooks

Replaceable by the President at will

Director Gruenberg

Term Ended: November 2017

CFPB Director Kraninger

Removable by the President at will

Vacant

OCC

Led by the Comptroller of the Currency

Comptroller Brooks is serving in an acting capacity.

He is replaceable by the President at will.

CFPB

Led by a Director

Director Kraninger's term ends December 2023.

She is removable by the President at will.

*All nominations are subject to Senate confirmation

Appendix (cont'd)

SEC

Chairman Clayton

Term Ends: June 2021

Commissioner Lee

Term Ends: June 2022

Commissioner Roisman

Term Ends: June 2023

Commissioner Crenshaw

Term Ends: June 2024

Commissioner Peirce

Term Ends: June 2025

CFTC

Chairman Tarbert

Term Ends: April 2024

Commissioner Quintenz

Term Ended: April 2020

Commissioner Benham

Term Ends: June 2021

Commissioner Stump

Term Ends: April 2022

Commissioner Berkovitz

Term Ends: April 2023

*All nominations are subject to Senate confirmation