LOEB & LOEB LLP

FinReg Round-Up

NEWSLETTER

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The Banking Regulators Have Been Busy–Volcker Rule Changes and More

In one day, the federal financial regulatory agencies individually and collectively issued a basketful of proposed and final rules, all long awaited.

- The Federal Reserve Board approved a final rule intended to simplify and increase the transparency of the rules for determining control of a banking organization.
- The Federal Deposit Insurance Company (FDIC) approved a final rule amending the Securitization Safe Harbor Rule for bank receiverships by removing the safe harbor requirement that disclosures in connection with the securitization comply with Regulation AB, even where Regulation AB itself is not applicable to the transaction.
- The Federal Reserve Board, FDIC, Office of the Comptroller of the Currency (OCC), SEC and Commodity Futures Trading Commission (CFTC) jointly approved a proposed rule that would make a number of changes to the Volcker Rule prohibitions on banking entities owning or sponsoring covered funds, including the following:
    - Exempting certain foreign funds that are not themselves covered funds due to limited U.S. nexus but are "banking entities" due to ownership or control by a foreign banking entity that operates in the United States
    - Revising the exclusions from the definition of "covered fund" for foreign public funds, loan securitizations and small-business investment companies

- Introducing new exclusions from the definition of "covered fund" for credit funds, qualifying venture capital funds, family wealth management vehicles and customer facilitation vehicles
- Permitting certain affiliate transactions that are currently prohibited under the provision commonly known as Super 23A
- Allowing a banking entity to exclude from its ownership interest calculations certain investments made in parallel with a covered fund, as well as certain restricted profit interests held by an employee or director

Nothing unexpected appears in the two final rules, which are both substantially consistent with the rules as proposed. Both rules have been on many regulatory wish lists for some time.

The proposed changes to the Volcker Rule are almost certain to garner a lot of industry attention. The changes include a number of long-sought amendments, some of which will likely draw more comment than others. We expect that, in particular, the proposed exclusions from the definition of "covered fund" for credit funds, qualifying venture capital funds, family wealth management funds and consumer facilitation vehicles will draw a significant amount of comment.

The comment period on the proposed rule will be open until April 1. We do not have any predictions yet on when a final rule might be issued, but we would be surprised if anything were finalized this year.

LIBOR Phase-Out Is 2 Years Away, But You Need a Transition Plan Now

Although LIBOR is not expected to be completely phased out until the end of 2021 and the industry has undertaken a number of initiatives in preparation, the financial regulators have made it clear (some with more emphasis than others) that banks and other supervised financial institutions need a LIBOR transition plan now.

The New York State Department of Financial Services issued a letter requiring all institutions it supervises (not just banks) to submit a written plan describing the institution's plan to address its LIBOR cessation and transition risk. The deadline for submitting responses has been extended until March 23.

Taking a lighter touch, the OCC noted in its Semiannual Risk Perspective for Fall 2019 that the change from LIBOR to a replacement index poses compliance and reputation risk and that banks it supervises should focus on the effect on consumer products, not just commercial loan agreements. The OCC noted that disclosures and other communications regarding the effect of the LIBOR phase-out on products should be easily comprehensible. The OCC stated that it is "increasing oversight of this area through 2020 and 2021." National banks, federal thrifts and other financial institutions supervised by the OCC should plan for LIBOR transition to be a topic of inquiry during their supervisory exams for at least the next two to three years.

CSBS Seeking To Balance State Sovereignty and Interstate Regulatory Harmonization in Money Transmitter Licensing

At some point, any fintech company with a consumer-facing financial product will be asked by an investor, lender or regulator the much-dreaded question of whether it has analyzed the need to obtain state money transmitter/money services business licenses in one or more states. The complexities involved in determining whether state money transmitter laws apply to a particular financial product is a discussion for another day (and one we can talk about at length). Our focus for right now is on the complexities of the multistate money transmitter licensing process.

The licensing process itself has proven to be a significant barrier to entry. It is rarely if ever efficient from a cost and time perspective for a new fintech company to obtain licenses nationwide, often resulting in innovative products being offered only in the more populous states. Recognizing this barrier, the Conference of State Bank Supervisors (CSBS) launched its "Vision 2020 for Fintech and Nonbank Regulation" to modernize state regulation and harmonize multistate supervision of the fintech and nonbank companies that are supervised at the state level.

Improvements in the money transmitter licensing process are already evident:

- As outlined by the most recent CSBS Fintech Industry Advisory Panel Accountability Report, the CSBS has been successful in getting more states to use the National Multistate Licensing System (NMLS) for licensing. For states that use the NMLS, there are checklists of requirements that are helpful in managing a multistate licensing process.
- After a successful pilot program, 27 states have now signed on to the Multistate MSB Licensing Agreement Program in which states agree to share resources and accept the work of other states in reviewing some parts of license applications. However, the multistate program does not eliminate state-specific requirements for licensing.
- The CSBS has developed its own model money services business law, but it is only in draft form. This model law is distinct from the Uniform Law Commission's Money Services Act of 2000 (amended 2004), which has been enacted by 10 states, some as recently as 2016. It is not clear yet what the states' appetites are for amending or replacing their current money transmitter laws.

But don't throw out your multistate money transmitter licensing checklists and cheat sheets just yet (anyone working in this space has at least one). The increased use of the NMLS and the Multistate Program is far from a panacea, and reconciling state sovereignty versus the desire for uniformity is difficult. CSBS' Vision 2020 Initiative has not removed the complexities and barrier to entry created by variations in state money transmitter laws and interpretations of the laws.

We are clearly a long way away from a simple and streamlined multistate money transmitter licensing process.

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