FinReg Round-Up

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June proved to be an unexpectedly busy month in financial regulation. As expected, there have been further developments in both the Paycheck Protection Program and the Main Street Lending Program. There were also some notable developments unrelated to COVID-19.

Main Street Lending Program

The Main Street Lending Program (MSLP) has finally launched. Lenders can now register through an online loan portal and immediately start making loans under the program. The current versions of all the required forms, agreements, and terms and conditions are available online and are updated as needed. The Federal Reserve also continues to update its Main Street Lending Program FAQs, which is now almost 75 pages long. Both the complexity of the program and the relatively small number of banks that have reportedly signed up for the program so far have resulted in a slow rollout of the MSLP, and the overall interest in and impact of the $600 billion programvremain to be seen.

Paycheck Protection Program

The Paycheck Protection Program Flexibility Act of 2020, which became law on June 5, made sought-after changes to the Paycheck Protection Program (PPP). Significant changes include:

- The "covered period," which was originally eight weeks from the date of disbursement of the loan, has been extended to the earlier of 24 weeks from the date of disbursement of the loan or Dec. 31, 2020. A borrower with an existing loan can elect to retain the current eight-week covered period.
- The percentage of PPP funds that must be used on payroll costs was lowered from 75% to 60%.
- Due to concerns about being able to fully reopen businesses and the willingness of employees to return, the amount of any loan forgiveness is calculated without regard to the reduction of full-time-equivalent (FTE) employees if the borrower, in good faith:
- Is able to document both an inability to rehire individuals who were employees of the eligible recipient on Feb. 15 and an inability to hire similarly qualified employees for unfilled positions on or before Dec. 31.

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OR

- Is able to document an inability to return to the same level of business activity at which the business was operating before February 15 due to compliance with COVID-19-related sanitation, safety or social-distancing requirements established or guidance issued by the Department of Health & Human Services(HHS), the Centers for Disease Control (CDC) or the Occupational Safety and Health Administration(OSHA).

The Small Business Administration (SBA) continues to release interim final rules and FAQs to implement the Flexibility Act and address additional questions about the PPP.

In addition, the SBA and the U.S. Department of the Treasury released updated applications for forgiveness, including an "EZ" application for borrowers who do not have changes in the number of FTE employees or salaries that could cause a reduction in the amount eligible for forgiveness. Applications and instructions are available on both the Treasury PPP website and the SBA PPP website.

Supreme Court Rules on CFPB Constitutionality

The U.S. Supreme Court, in a 5 – 4 decision published on June 29, 2020, ruled that the current structure of the Consumer Financial Protection Bureau (CFPB) is unconstitutional. As a result, the president is free to fire the CFPB's director at any time, without cause.

Created in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act in order to protect consumers, the CFPB has long been a target of business groups and the current administration, which have argued that the Bureau overregulates a wide range of businesses that provide consumer-facing financial products and services. Indeed, the CFPB has formidable enforcement powers. In addition to its rule-making authority, it has the ability to conduct investigations, issue subpoenas and civil investigative demands, initiate administrative adjudications, prosecute civil actions in federal court, and issue substantial civil penalties.

As part of the Executive Branch, the CFPB's director is appointed by the president. But under the Dodd-Frank Act, the president can remove the director only for cause, defined as "inefficiency, neglect of duty or malfeasance." Critics of the CFPB have argued that the CFPB lacks meaningful oversight and violates Article II of the Constitution, which gives the president the power to remove—and supervise—those who wield executive power on his behalf.

The Court concluded that by concentrating power in the CFPB's director—a single individual insulated from presidential control—the structure of the CFPB violates the separation of powers. The Court added that the CFPB may continue its mission, but its director must be removable by the president at will.

With this decision putting an end to years of litigation over its constitutionality, the CFPB can now proceed to carry out its mission. But given the president's ability to replace a director whose actions do not conform with the president's views, it is unclear whether the CFPB can chart a steady course given that it will now be subject to political pressures. And some businesses regulated by the CFPB could see the Court's ruling as a potential opportunity to challenge the agency's authority to pursue enforcement actions.

Volcker 2.1—Changes to Volcker Rule Covered Fund Prohibitions Finalized

The five financial regulatory agencies responsible for the implementation of Section 13 of the Bank Holding Company Act, commonly known as the "Volcker Rule," have jointly issued a final rule updating the Volcker Rule prohibitions on a banking entity acquiring or retaining an ownership interest in, sponsoring or having certain relationships with hedge funds or private equity funds. The final rule follows closely behind the December 2019 rule (sometimes called Volcker 2.0) that made changes to the proprietary trading prohibitions of the Volcker Rule. It also comes practically on the heels of the February 2020 proposed rule, an extra-impressive regulatory feat in light of the COVID-19 pandemic and quarantines.

The final rule is substantially similar to the proposed rule and makes a number of long-sought-after changes to the Volcker Rule covered funds prohibitions, including:

- Clarifying that qualifying foreign funds that currently fall under the definition of a "covered fund" due to their affiliation with a foreign banking entity are exempt from the restrictions of the Volcker Rule.
- Revising the "Super 23A" provision of the Volcker Rule by allowing a banking entity to enter into low-risk transactions with a related covered fund that would be permissible without limit under Section 23A of the Federal Reserve Act and its implementing regulations (Regulation W).
- Simplifying covered fund exclusions for foreign public funds, loan securitizations, small business investment companies and public welfare investments.
- Allow banking entities to invest in and sponsor a number of additional categories of funds that would otherwise be covered funds, including qualifying credit funds, venture capital funds, family wealth management vehicles and customer facilitation funds.
- Clarifying that "ownership interest" does not include a loan or debt interest with certain traditional creditor rights, and providing an express safe harbor for senior loans and senior debt.

Although these amendments have already drawn criticism as a "rollback" of the Volcker Rule, a number of the changes, including the changes to the "Super 23A" regulations and the foreign excluded funds provisions, are intended to address what are largely considered to be unintended consequences of the original Volcker Rule regulations. The remaining changes are, in the view of the financial regulatory agencies, consistent with the intent of the Volcker Rule and are considered to be low-risk activities for banking entities, although, of course, opinions differ regarding the level of risk.

The final rule will be effective on Oct. 1, 2020.

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