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Cool It

September 8, 2022

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In This Issue ...

As we "go to press" with this week's issue, we are deeply saddened to learn of the passing of Her Majesty Queen Elizabeth II. Our thoughts are with the Royal Family at their time of personal grief, and we share our condolences with our readers in the United Kingdom, the Commonwealth and around the world. We recognize and admire her lifetime of service to her country.

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We couldn't help but notice this week that the post-summer traffic is back, along with packed commuter trains and buses and increased rush-hour foot traffic just about everywhere. And the hot summer has made way for some cool fall breezes.

As we've been saying for weeks, though, the financial services industry and the regulatory agencies never really took a summer vacation, and this week we look at the first policy speech from Federal Reserve Vice Chair of Supervision Michael Barr and guidance from the FTC and the FDIC. Our Financial Restructuring colleague Casey Servais also provides an in-depth look at *Fairfield Sentry Ltd. v. Citibank, N.A. London*, a case coming out of the Madoff Ponzi scheme, in which the U.S. District Court for the Southern District of New York confirmed that the U.S. Bankruptcy Code's safe harbor provisions protect against foreign law "clawback" claims in cases under Chapter 15.

Busy times mean lots of questions. And we're here to help. Please don't hesitate to reach out with general questions or with comments on this week's issue of *Cabinet News and Views*. You can write to us here.

Daniel Meade and **Michael Sholem**
Co-Editors, *Cabinet News and Views*

FRB Vice Chair of Supervision Barr Gives First Speech Since Taking Office

By **Daniel Meade**
Partner | Financial Regulation

Federal Reserve Vice Chair of Supervision Michael Barr gave remarks yesterday to the Brookings Institution in Washington, D.C. The speech was his first since being sworn in at the end of July and served as a good indicator of his policy agenda.

In the speech, Vice Chair Barr laid out some of his near-term priorities that would build on what has worked since implementation of the Dodd-Frank Act to achieve his overarching goals of "helping to make the financial system safer and fairer..."

He emphasized that the goals of both a safer and fairer financial system should be complementary rather than competing. He noted that keeping the financial system safe "involves an active and never-ending effort to analyze risks and make necessary adjustments." Vice Chair Barr laid out a number of his near-term priorities that could be characterized under the safety goal. The near-term goals include action on capital requirements, resolution of failed/failing financial institutions, bank merger policy review, stablecoins, and financial risks from climate change. We summarize some of the particulars on each below.

Capital: Vice Chair Barr stated that "[w]e are looking holistically at our capital tools to understand how they are supporting the resilience of the financial system, individually and in combination." He also noted that they will be taking a holistic view of the supplementary leverage ratio, the countercyclical capital buffer, and stress-testing requirements under the current rules. Moreover, he said, "I am also committed to implementing enhanced regulatory capital requirements that align with the final set of 'Basel III' standards or the so-called 'Basel endgame,'" and that he will have more to say on that this fall.

Resolution Planning: Vice Chair Barr said that the Fed would continue to work with the FDIC to "rigorously review" the resolution plans required for globally systemically important banks ("G-SIBs"). He also seemed to echo Acting Comptroller Michael Hsu's remarks made in April that resolution plans should possibly be required beyond just G-SIBs, but noted that any future policy actions in that space would be developed with the FDIC and OCC and after public comment.

Bank Merger Policy Review: Vice Chair Barr stated that another of his priorities is to evaluate the FRB's approach to reviewing bank mergers and acquisitions. He noted: "I am working with Federal Reserve staff to assess how we are performing merger analysis and where we can do better."

Stablecoins: Vice Chair Barr noted that unregulated stablecoins could pose financial stability risks. He said: "I believe Congress should work expeditiously to pass much-needed legislation to bring stablecoins, particularly those designed to serve as a means of payment, inside the prudential regulatory perimeter." This is

another instance where Vice Chair Barr's comments appear to echo Acting Comptroller Hsu's previous comments.

Financial Risks from Climate Change: Vice Chair Barr stated that, in the near-term, the FRB intends to work with the OCC and FDIC to provide guidance to large banks on expectations on how they should "identify, measure, monitor, and manage the financial risks of climate change." He also announced that "next year we plan to launch a pilot micro-prudential scenario analysis exercise to better assess the long-term, climate-related financial risks facing the largest institutions."

Vice Chair Barr then turned to priorities to achieve his objective of making the financial system fairer. He reiterated what he views as the three essential elements of fairness in the financial system: financial capability, financial access, and consumer protection. He noted that innovation has an important role to play in giving more access to those who may have been left behind in the past, but that vigilance is needed in assessing any new risks with such innovation, and specifically that "[c]rypto-asset related activity, both outside and inside supervised banks, requires oversight so that people are fully aware of the risks they face." He noted that the innovation of faster payments could be very useful to helping low-income households. He closed his remarks on fair access to financial services by noting the ongoing efforts by the FRB, FDIC, and OCC on the proposal to strengthen and modernize the Community Reinvestment Act.

In his conclusion, Vice Chair Barr said that he will "have more to say about these ideas, and other important reforms, in the coming weeks and months."

Non-Creditor Advertising of Credit Pre-Approvals Likely Deceptive

By **Mercedes Kelley Tunstall**
Partner | Financial Regulation

The federal banking regulators have guidance in place regarding the advertising of credit pre-approvals, and, of course, Regulation Z and the Truth In Lending Act have provisions regarding how and when a pre-approval can be communicated to customers. Further, a "pre-approval" for credit is a standard that is supposed to mean that the consumer's credit has been evaluated at some level by the creditor (usually via so-called prescreening, or because the customer agreed to an initial evaluation), and that the consumer will be approved for the credit product, assuming an intervening bankruptcy or other extremely adverse credit event has not occurred.

In a recent case involving Credit Karma as the advertiser, the Federal Trade Commission ("FTC") established that consumers do perceive messaging that they have been pre-approved for credit to be consistent with the standard described. According to disclosures buried in the ads, Credit Karma claimed that 90% of the recipients of the "pre-approved" offers would be approved, when, in fact, more than one-third of customers responding to the advertising were declined for the offers. And, in order for the customers to obtain the pre-approved offers, they needed to agree to allow their credit to be queried, causing a "hard pull" to be made of their credit report, an activity that typically will lower a consumer's credit score.

In truth, Credit Karma presented advertising telling their customers that they had been pre-approved for various credit products, but had not actually conducted any credit review of the customer and had no contact with the creditors providing the credit products being advertised. As such, that advertising was found to be deceptive under Section 5 of the FTC Act, and despite the FTC's inability to obtain redress for violations of Section 5 in federal court, Credit Karma agreed to pay $3 million to the FTC to resolve the allegations in the administrative complaint the FTC had filed against the company.

FDIC: Consumers Need Awareness of ESG Concerns, Too

By Mercedes Kelley Tunstall
Partner | Financial Regulation

In many corners of financial services, Environmental, Social and Governance ("ESG") concerns are driving innovation, SEC disclosure requirements, and even risk and compliance assessments. However, first among the prudential banking regulators, the FDIC on September 2 released a consumer advisory on ESG considerations, specifically regarding the impact of "Banking on the Environment."

The advisory provides several ways that consumers can direct their financial activities to help them "go green" and "possibly reduce" their carbon footprint. Conducting banking activities electronically was at the top of the list of the FDIC's suggestions – which includes everything from using direct deposit for paychecks to signing up for electronic statements and using online functionalities to pay bills, deposit checks and transfer funds. The FDIC also mentioned considering a home improvement loan to improve home efficiency or to address environmental impacts, and considering financing for electric, hybrid or fuel-efficient cars. Rounding out the suggestions, the FDIC encouraged consumers to consider canceling junk mail, using public transportation or walking or biking, and finding "new ways to reuse items or borrow them, instead of buying new."

In Depth: U.S. Bankruptcy Code Safe Harbors Protect Against Foreign Law Avoidance Claims under Chapter 15

By **Casey Servais**
Partner | Financial Restructuring

The U.S. Bankruptcy Code's safe harbor provisions provide comfort to financial institutions that transfers made under protected financial contracts will generally not be subject to avoidance or "clawback" if the transferor subsequently files for bankruptcy protection under Chapter 7 or Chapter 11 of the U.S. Bankruptcy Code. But is the same true where the transferor is a foreign debtor whose main insolvency proceeding is occurring outside the United States, and whose representatives merely petition for "recognition" of the foreign proceeding in the United States under Chapter 15 of the Code? The U.S. District Court for the Southern District of New York recently confirmed that the safe harbors provide protection under this circumstance as well, even with respect to foreign law claims based on foreign transactions. *See Fairfield Sentry Ltd. v. Citibank, N.A. London*, 2022 WL 3644436 (S.D.N.Y. Aug. 24, 2022).

Background

Fairfield involved three investment funds organized in the British Virgin Islands ("BVI") that invested in Bernard Madoff's Ponzi scheme. After Madoff's scheme collapsed, the funds became subject to insolvency proceedings in a BVI court, which appointed liquidators to recover and equitably distribute assets on behalf of the members of the funds. The liquidators, acting as the funds' "foreign representatives," obtained recognition of the BVI insolvency proceedings in the SDNY Bankruptcy Court under Chapter 15. The liquidators also initiated proceedings in the U.S. under the BVI Insolvent Act, seeking to avoid certain allegedly preferential or constructively fraudulent payments made to investors who had cashed out their investments in the funds prior to the Madoff scheme's collapse. The Bankruptcy Court ultimately dismissed these BVI law claims as barred by the Bankruptcy Code's Section 546(e) safe harbor, which generally prevents avoidance of a "settlement payment...made by or to (or for the benefit of) a... financial institution...in connection with a securities contract."

The Appeal

On appeal, the District Court affirmed the Bankruptcy Court's holding that the BVI law avoidance claims were barred by the 546(e) safe harbor.

In doing so, the District Court rejected the liquidators' argument that Section 546(e) applied only to transactions within the United States and not "extraterritorially" to foreign transactions. The Court recognized a general presumption against extraterritorial application of a statute, but held that 546(e) applied notwithstanding this presumption under a two-step analysis developed by the U.S. Supreme Court that considers (i) whether the statute gives a clear indication that it applies extraterritorially, and (ii) whether the case involves a

domestic application of the statute, as determined by looking to the statute's "focus."

With respect to the first step, the Court concluded that Congress had expressed a clear intent to apply 546(e) extraterritorially through Section 561(d) of the Bankruptcy Code, which provides that under Chapter 15 the safe harbors "limit avoidance powers to the same extent as in a proceeding under chapter 7 or 11." 11 U.S.C. § 561(d). The Court reasoned that because Section 561(d) requires the safe harbors to apply under Chapter 15 "to the same extent" as under Chapter 7 or 11, and because under Chapter 7 or 11 the safe harbors would bar all preference and constructive fraudulent transfer claims with respect to protected parties and contracts, the 546(e) safe harbor must similarly bar all analogous claims in a Chapter 15 case, even if brought with respect to non-U.S. transactions and under foreign law.

With respect to the second step, the Court concluded that application of the 546(e) safe harbor was domestic rather than extraterritorial, because the "focus" of the safe harbor was ultimately to limit the foreign representatives' avoidance powers in a U.S. court.

Importantly, the Court also recognized that under Chapter 15, as under Chapters 7 and 11, the Section 546(e) safe harbor does not bar claims based on intentional, as opposed to constructive, fraud. The Court concluded, however, that the *Fairfield* liquidators had not asserted any intentional fraud claims, because their BVI law claims related only to unfair preferences and constructively fraudulent transfers. Therefore, the exception for intentional fraud did not apply in this case.

Takeaways

The *Fairfield* decision gives financial institutions increased comfort that under Chapter 15, just as under Chapters 7 and 11, the U.S. Bankruptcy Code's safe harbor provisions should render transactions under protected financial contracts immune from "clawback" based on preference or constructive fraudulent transfer claims. However, just as under Chapters 7 and 11, this Chapter 15 immunity does not extend to claims based on intentional fraud.

Welcoming Leading Financial Restructuring Partner Mike Rupe

We are pleased to welcome partner Mike Rupe to our Financial Restructuring Group in New York. He joins as Head of Special Situations and Reorganizations.

Mike advises financial institutions in all aspects of in- and out-of-court workout, restructuring and reorganization matters, with an emphasis on advising ad hoc lender groups. Mike has represented creditor groups in a number of high-profile chapter 11 cases and out-of-court restructurings, including those of CEC Entertainment, APC Automotive Technologies, Fairway Group Holdings, Gymboree Group and Payless Holdings, among others. Among his career highlights, Mike led the team representing a cross-over lender group in the chapter 11 cases of Nine West Holdings, for which he was recognized by *IFLR1000* as a finalist for "Lawyer of the Year: Restructuring and Insolvency."

Mike formerly practiced at King & Spalding, where he served as Head of Financial Restructuring.

Read the full announcement here.