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Informed analysis for the financial services industry

Make Room for Crypto

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The arrival of warmer weather and the baseball season didn't translate to spring break for regulators – not with the daily drumbeat on digital assets and crypto drowning out the splish-splash of beach and poolside follies.

This week's *Cabinet News and Views* takes a look at more developments in the crypto space, and provides some commentary on an important financial stability speech from U.S. Acting Comptroller Hsu on how large regional banks would be resolved if they were to fail.

What do you think? We'd love to hear from you. Just write to us here.

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

Treasury Secretary Yellen on Digital Assets Policy, Innovation and Regulation

By **Michael Ena**
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On April 7, 2022, Secretary of the Treasury Janet Yellen delivered remarks on digital assets policy, innovation and regulation. Yellen started by noting that, a few weeks ago, President Biden signed an Executive Order on a comprehensive government approach to digital asset policy, which tasks experts across the federal government with conducting in-depth analysis to balance the responsible development of digital assets with the risks they present. This task will be guided by six policy objectives:

1. protect consumers, investors and businesses;
2. safeguard financial stability from systemic risk;
3. mitigate national security risks;
4. promote U.S. leadership and economic competitiveness;
5. promote equitable access to safe and affordable financial services; and
6. support responsible technological advances, which takes into account considerations related to privacy, human rights and climate change.

In connection with that, Yellen shared the following five lessons that will guide the future work in this area:

1. The U.S. financial system benefits from responsible innovation. The introduction of new technologies, such as a Central Bank Digital Currency, or "CBDC," while appropriately managing risks, can make the U.S. financial system more efficient and safe for most Americans.
2. When regulation fails to keep pace with innovation, vulnerable people often suffer the greatest harm.
3. Regulation should be based on risks and activities, not specific technologies. Wherever possible, regulation should be "tech neutral."
4. Sovereign money is the core of a well-functioning financial system, and the U.S. benefits from the central role that the dollar and U.S. financial institutions play in global finance. CBDC could be the next evolution of U.S. currency, which, according to Yellen, would require years of development.
5. We need to work together to ensure responsible innovation. Further, technology-driven financial innovation is inherently cross-border and requires international cooperation.

Yellen stressed that the government should ensure the development of digital assets that work for all Americans, protect the national security interests and the planet, and contribute to U.S. economic competitiveness and growth. To achieve that, however, in addition to enacting appropriate regulations aimed at the reduction of risks inherent in digital assets, the U.S. may need to accelerate the development of its CBDC beyond the timeline envisioned by Yellen, taking into account that the digital Yuan CBDC is already available and is intended to directly compete and replace the U.S. dollar and USDT stablecoin.

FDIC Weighs In on Crypto Activities

By **Daniel Meade**
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Last week, the FDIC issued a Financial Institution Letter ("FIL") related to crypto activities, following in some ways in the footsteps of the OCC in requiring notice to the regulator before engaging in crypto-related activities. The FDIC stated that "[a]n FDIC-supervised institution that engages, or intends to engage in, any crypto-related activities should notify the FDIC and provide any information requested by the FDIC that will allow the agency to assess the safety and soundness, consumer protection, and financial stability implications of such activities."

The FDIC further defined "crypto asset" to mean "any digital asset implemented using cryptographic techniques." The term "crypto-related activities" for the purposes of this FIL includes acting as crypto-asset custodians; maintaining stablecoin reserves; issuing crypto and other digital assets; acting as market makers or exchange or redemption agents; "participating in blockchain- and distributed ledger-based settlement or payment systems, including performing node functions; as well as related activities such as finder activities and lending." The FDIC noted further that "[t]he inclusion of an activity within this listing should not be interpreted to mean that the activity is permissible for FDIC-supervised institutions."

As noted by the FDIC, it is open to the innovation that crypto assets provide but is concerned that the fast evolution of crypto assets may present risk to insured depository institutions. Thus, "to assess the safety and soundness, consumer protection, and financial stability implications of such activities," the FDIC is requiring prior notice (or in the case of institutions that are already engaged in such activities, post notice).

Sending a Message: The CFPB's Charges Against TransUnion


By **Kendra Wharton**
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By **Sara Skutch**
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For months, Director Rohit Chopra warned that the Consumer Financial Protection Bureau (the "Bureau") would sharpen its focus on repeat offenders.[1] On April 12, 2022, the Bureau demonstrated its resolve, announcing charges against national credit reporting agency TransUnion, two of its subsidiaries, and a long-time executive for violating a 2017 consent order that prohibited TransUnion from deceptively marketing credit scores and credit-related products.[2]

In January 2017, the Bureau issued a consent order against TransUnion to address findings that the credit reporting agency violated the Consumer Financial Protection Act ("CFPA") by deceptively marketing credit-related products. The consent order required TransUnion to pay $13.93 million in restitution to consumers, to pay a $3 million civil penalty, and to abide by certain conduct provisions. However, the Bureau found more than a year later during a supervisory exam that TransUnion was still using deceptive marketing practices, including website and app design features ("digital dark patterns") intended to trick consumers into purchasing credit-related subscriptions and to make it difficult to cancel them. The Bureau alleges that it informed TransUnion repeatedly, beginning in 2019, that it was in violation of the 2017 consent order.

On April 12, 2022, the Bureau filed its complaint in federal district court for alleged violations of the CFPA, the Electronic Fund Transfer Act, and the Fair Credit Reporting Act, as well as their implementing regulations.[3] The Bureau is seeking consumer redress, disgorgement, injunctive relief, and the imposition of civil money penalties for TransUnion's violations.

Taking a closer look, the Bureau's action against TransUnion is particularly noteworthy, as it demonstrates Director Chopra's commitment to stepping up enforcement in several significant ways, including:

- **The Bureau will take aggressive action against those who stall or avoid implementing the terms of a consent order because they may negatively impact the company's bottom line**. Director Chopra recently expressed frustration that corporate recidivism has become normalized and calculated as the cost of doing business. He warned that the Bureau will forcefully address repeat offenders to "alter company behavior and ensure they realize it is cheaper, and better for their bottom line, to obey the law than to break it."[4] The TransUnion action reinforces this commitment. The Bureau has signaled it will seek millions in consumer redress and civil money penalties, but the Bureau may also seek "structural" changes at TransUnion, such as prohibitions against certain business activities.[5]

- **The Bureau will also charge individuals for "egregious" conduct, such as taking an active role in repeat offenses.** In recent comments about corporate recidivism, Director Chopra indicated that it may charge senior managers and executives and seek lifetime occupational bans when they play a role in repeat offenses and order violations.[6] The Bureau's complaint against TransUnion includes charges against a long-time executive for his role in violating the 2017 consent order, based in part on allegations that he instructed employees to remove an opt-in check-box required by the consent order.

- **The Bureau will dedicate significant resources to identify and address digital dark patterns that are intended to trick or trap consumers**. In remarks regarding the complaint, Director Chopra emphasized that many other companies are using digital dark patterns to steer customers.[7] For example, TransUnion is alleged to have integrated colorful, deceptive buttons and low-contrast, fine-print disclosures into its website. Director Chopra stated that the Bureau will be working with the Federal Trade Commission, the Department of Justice, state attorneys general, and international partners to combat these types of tactics.

- **The Bureau will leverage insider information to support its enforcement activities**. In its announcement of the TransUnion complaint, the Bureau specifically called on current and former employees with information about the company's misconduct to report that information through the CFPB's whistleblower program. Unlike other whistleblower programs, such as those of the SEC and CFTC, the CFPB does not currently have authority to award bounties. (Individuals who report information about possible consumer financial protection violations to the Bureau are protected against retaliation.) Even so, the Bureau's request, which follows a separate call to action for IT employees at financial institutions,[8] suggests that the Bureau believes many industry insiders will nonetheless come forward with critical information about consumer financial protection violations.

[1] *See* Prepared Remarks, Dir. Rohit Chopra, "Reining in Repeat Offenders": 2022 Distinguished Lecture on Regulation, University of Pennsylvania Law School (Mar. 28, 2022), https://www.consumerfinance.gov/about-us/newsroom/reining-in-repeat-offenders-2022-distinguished-lecture-on-regulation-university-of-pennsylvania-law-school/; Prepared Remarks, Dir. Rohit Chopra, December NAAG Meeting (Dec. 7, 2021), https://www.consumerfinance.gov/about-us/newsroom/director-chopra-remarks-december-naag-meeting/; Press Release, CFPB, "CFPB Names New Chiefs for Supervision and Enforcement Positions" (Oct. 29, 2021), https://www.consumerfinance.gov/about-us/newsroom/cfpb-names-new-chiefs-for-supervision-and-enforcement-positions/; Opening Statement of Director Rohit Chopra before the Senate Committee on Banking, Housing, and Urban Affairs (Oct. 28, 2021), https://www.consumerfinance.gov/about-us/newsroom/opening-statement-director-rohit-chopra-before-senate-committee-banking-housing-urban-affairs/.

[2] Press Release, CFPB, CFPB Charges TransUnion and Senior Executive John Danaher with Violating Law Enforcement Order (Apr. 12, 2022),

https://www.consumerfinance.gov/about-us/newsroom/cfpb-charges-transunion-and-senior-executive-john-danaher-with-violating-law-enforcement-order/.

[3] Complaint, *CFPB v. TransUnion*, Case No. 1:22-cv-1880 (N.D. Ill. Apr. 12, 2022), *available at* https://files.consumerfinance.gov/f/documents/cfpb_transunion_complaint_2022-04.pdf.

[4] Prepared Remarks, Dir. Rohit Chopra, "Reining in Repeat Offenders": 2022 Distinguished Lecture on Regulation, University of Pennsylvania Law School (Mar. 28, 2022), https://www.consumerfinance.gov/about-us/newsroom/reining-in-repeat-offenders-2022-distinguished-lecture-on-regulation-university-of-pennsylvania-law-school/.

[5] Director Chopra recently stated that 12 U.S.C. § 5565, which allows the Bureau to seek "limits on activities or functions of [a] person" in court or administrative proceedings, can be used to make "structural" changes at financial services firms to forestall future violations. For example, another repeat offender, LendUp, was effectively "shuttered" in December 2021 after the Bureau obtained injunctive relief prohibiting the firm from making new loans, collecting on outstanding loans or selling consumer information. The complaint filed against TransUnion requests "injunctive relief against each of the Defendants as the Court deems just and proper," but it isn't clear at this time what relief the Bureau will seek.

[6] Prepared Remarks, Dir. Rohit Chopra, "Reining in Repeat Offenders": 2022 Distinguished Lecture on Regulation, University of Pennsylvania Law School (Mar. 28, 2022), https://www.consumerfinance.gov/about-us/newsroom/reining-in-repeat-offenders-2022-distinguished-lecture-on-regulation-university-of-pennsylvania-law-school/.

[7] Director Chopra's Prepared Remarks on the Repeat Offender Lawsuit Against TransUnion and John Danaher (Apr. 12, 2022), https://www.consumerfinance.gov/about-us/newsroom/director-chopras-prepared-remarks-on-the-repeat-offender-lawsuit-against-transunion-and-john-danaher/.

[8] Erie Meyer, *CFPB Blog*, "CFPB Calls Tech Workers to Action" (Dec. 15, 2021), https://www.consumerfinance.gov/about-us/blog/cfpb-calls-tech-workers-to-action/.

Final Draft Technical Standards on Risk Retention Requirements for Securitisations Published by EBA

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On April 12, 2022, the European Banking Authority (the "EBA") issued a press release announcing the publication of its final draft Regulatory Technical Standards ("RTS"), setting out the requirements for originators, sponsors and original lenders related to risk retention. Publication of these final draft RTS follows a consultation launched in June 2021. The RTS, which have been long awaited following publication of a first version back in 2018, are mandated by Article 6(7) of the EU Securitisation Regulation, and are intended to provide clarity on the risk retention requirements, ensure a better alignment of interests, and further develop a secure and healthy securitisation market in the EU.

These draft RTS substantially carry over the provisions on risk retention from the previous 2018 draft RTS. Several modifications have been made to the provisions on risk retention to try to ensure greater consistency and to provide clarity in various areas, including the adverse selection of assets by originators. The primary aim of these changes, according to the EBA, is to "facilitate the securitisation of non-performing exposures [NPE] and are part of EBA's broader work on supporting the functioning of the secondary markets for NPE." Nonetheless, there are some key additional technical drafting changes that do not relate directly to NPE that will be the subject of a further Cadwalader Clients & Friends memorandum next week.

The RTS will enter into force on the 20th day following publication in the Official Journal, replacing the earlier risk retention standards made under the EU Capital Requirements Regulation.

Securities Litigation Update: Courts of Appeal Address the Exchange Act's Exclusive-Jurisdiction and Non-Waiver Provisions, the Duty to Disclose and Scienter


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In the first quarter of 2022, federal appellate courts issued a number of thought-provoking (albeit not monumental) decisions addressing the reach of the federal securities laws and, in some cases, highlighting potentially powerful defenses for litigants. Here we discuss the following developments:

<u>The Exchange Act's exclusive-jurisdiction and non-waiver provisions</u>. In *Seafarers Pension Plan v. Bradway*, the Seventh Circuit reinstated a derivative claim brought in federal court under Section 14(a) of the Securities Exchange Act, based on allegedly false and misleading statements in proxy solicitation materials. The Court declined to enforce a bylaw that, on its face, would have restricted all derivative claims to the Delaware Court of Chancery.

<u>Limits on issuers' disclosure obligations under Section 10(b)</u>. The Ninth and Second Circuits affirmed dismissal of securities fraud claims in two decisions, *Weston Family Partnership LLLP v. Twitter, Inc.* and *Arkansas Public Employees Retirement System v. Bristol-Myers Squibb Co.*, invoking the principle that, under Section 10(b), issuers do not have a generalized duty to disclose any and all information concerning their business or prospects, even if the information could be deemed material to investors.

<u>Pleading a "strong inference" of scienter</u>. The Second Circuit also issued two decisions, *Malik v. Network 1 Financial Services, Inc.* and *KBC Asset Management NV v. Metlife, Inc.*, affirming the dismissal of securities fraud claims based on plaintiffs' failure to plead a "strong inference" of "scienter" (an intent to deceive or defraud).

Read our Clients & Friends Memo here.

In Depth: Acting Comptroller Hsu Discusses Resolution Plans for Large Regional Banks

By **Daniel Meade**
Partner | Financial Regulation

In remarks made at the Wharton Financial Regulation Conference, Acting Comptroller Hsu hit on a familiar theme of financial stability but raised a new variation by discussing the financial stability impacts that the failure of a large regional bank could cause and large regional banks' resolvability. He noted that the country has made good strides in the resolvability of the eight U.S. Global Systemically Important Banks ("GSIBs"), but commented that a gap may exist for larger regional banks. He also noted that four large regional, non-GSIB banks each hold more than $500 billion in assets currently.

Acting Comptroller Hsu posed the question of how those large regional banks would be resolved if they were to fail. He noted that a purchase and assumption by one of the eight U.S. GSIBs could be a likely plan given past precedent, and that such a transaction would likely be successful at resolving the immediate failure of the large regional banks and stopping any possible contagion such a failure might have. However, he did not welcome the results of one of the GSIBs getting bigger in a "shotgun marriage" and adding to a GSIB's macro financial stability risk.

He suggested that the large regional banks could do three things we've learned from the GSIBs to become more resolvable, and that these elements could be imposed as conditions required when approving any merger or acquisition applications.

- First, require the regional banks to have a single point of entry ("SPOE") resolution plan.

- Second, as is the case with the GSIBs under the total loss absorbing capital ("TLAC") requirement, require "enough long-term debt at the parent to be 'bailed in' to absorb the kinds of losses that could cause a bank to fail." He went on to note that "[t]his serves as an important buffer, so that if the firm fails, private investors absorb the firm's losses and are 'bailed in' instead of taxpayers footing the bill for a bailout…."

- Third, Acting Comptroller Hsu noted that the banks need to be separable.

Acting Comptroller Hsu summarized by stating, "If a large regional adopted SPOE, had sufficient TLAC, and was separable, the government would have more options should the regional bank fail. If necessary, we would be able to break the bank up and keep its operations running, while allocating any unexpectedly large losses to private creditors instead of taxpayers. We would not be limited to simply folding it into a GSIB."

Summary of the Two Prominent Resolution Strategies

Acting Comptroller Hsu's call for large regional banks to utilize the SPOE resolution strategy currently utilized by the eight U.S. GSIBs makes this an opportune time to refresh our memories and compare the SPOE strategy to its main alternative, the multiple point of entry ("MPOE") resolution strategy.

Section 165(d) of the Dodd-Frank Act requires the largest bank holding companies (and other nonbank financial companies designated as systemically important) to prepare a plan for a "rapid and orderly resolution in the event of material financial distress or failure." These so-called living wills or resolution plans are reviewed by the FDIC and the Federal Reserve Board to determine each plan's credibility and whether it would facilitate an orderly resolution of the company under the Bankruptcy Code rather than the Orderly Liquidation Authority authorized in Title II of the Dodd-Frank Act.

The SPOE strategy focuses on a failing financial institution only at the level of a top-tier holding company, as opposed to the MPOE strategy, which generally requires the initiation of resolution proceedings at the level of the operating subsidiaries. An MPOE approach is generally what has been used when large bank holding companies failed prior to enactment of the Dodd-Frank Act. As Acting Comptroller Hsu noted in his remarks, the Lehman Brothers bankruptcy was an example of an MPOE resolution, with multiple bankruptcy and insolvency proceedings for the various entities.

Although the U.S. regulators have often stated that they are agnostic as to which strategy a GSIB chooses in its 165(d) plans, the regulators have also stated a clear preference for the SPOE strategy in their own Title II planning. Acting Comptroller Hsu's remarks suggest that at least the OCC believes the SPOE is the right strategy for large regional banks. Some large regional banks have tended to lean toward the MPOE strategy. This has made sense, given the large amounts of assets that are usually in the insured depository institution and, thus, would likely be resolved as part of a bank receivership or conservatorship by the FDIC under the Federal Deposit Insurance Act. However, Acting Comptroller Hsu has clearly laid down a marker for SPOE for large regional banks.

Conclusion

Notwithstanding Acting Comptroller Hsu's remarks, there is currently no requirement that large regional banks utilize the SPOE strategy. However, for any large regional bank that may have a merger transaction in its sights, movement to an SPOE strategy may be the easiest way to garner approval for any merger approvals, at least before the OCC.