Financial Services Management

GSIB Charter Revocation, Consumer Enforcement

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H.R. 3937, Megabank Accountability and Consequences Act of 2017

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Impact Assessment

- House Democrats have introduced legislation drafted in often-uncertain terms to punish Wells Fargo and perhaps other GSIBs far more dramatically than has been done to date. Due to its political approach, contentious consequences, unclear impact, and political opposition, the legislation will not advance as is. It nonetheless sends a strong signal about finreg politics as election season nears.
- Further scandals or other risks at large U.S. banks could lead to greater consensus, at least among Democrats, on aspects of this legislation.
- Premised on the view that small banks are held responsible for consumer violations that GSIBs evade, the legislation would make it far easier to shutter a GSIB for patterns or practices of consumer-protection violations, findings in which the CFPB would play a major role along with federal prudential regulators.
- GSIB franchise value would be threatened by franchise-termination risk unrelated to earnings or similar investor considerations.
- Senior officers and directors could face imprisonment for even minor violations if extensive duties are not undertaken and all supervisory expectations fully met.

Overview

The Ranking Member of the House Financial Services Committee, Rep. Maxine Waters (D-CA), and eight House Democrats have introduced legislation to force federal regulators to put any GSIB that fails to meet consumer-protection standards into receivership. In essence, the fate of the largest U.S. banks, U.S. operations of large foreign banks, and the prospects for investors, uninsured depositors, and counterparties would depend on full adherence to the letter and spirit of national and even state or local consumer-protection provisions or even just the opinions that federal regulators have about these requirements. Senior officers and directors would also be more easily held strictly responsible for violations and any liquidations resulting from them, with the scope of personal liability set so widely as to discourage most executives and directors from GSIB service.

Although the legislation has scant chance to advance in the current Congress, it speaks to progressive and populist discontent with very large banks and to broader questions about financial-service delivery and public trust. As a result, aspects of the legislation will play a role in public debate and could even advance if there are renewed scandals and/or greater Democratic control in the next Congress.

Impact

This legislation is premised on the view that the FRB, OCC, and FDIC do not take consumer protection seriously enough in their examinations and regulation of the largest banks. Convinced of this after the 2008 crisis, Congress created the CFPB in part to take over oversight of the largest banks, but Congress limited the Bureau's authority to consumer protection, leaving safety-and-soundness regulation to the federal agencies and thus in the bill's sponsors' view deferring too much to the federal banking agencies and putting consumers at undue risk. By literally authorizing a death sentence in the event of consumer-protection lapses, this bill is intended to give the Bureau far greater influence over the largest banks doing business in the U.S. and to hold the federal agencies accountable for demanding rapid remediation of errors spotted by their own examinations or industry critics, municipalities, and others who would now be given a voice on this life-or-death question.

However, despite this clear policy – or some might say, political – goal, the legislation is often drafted in uncertain terms that include internal contradictions or provisions so sweeping in their drafting as to make implementation challenging. For example, the legislation is clearly intended to force GSIBs with proven patterns or practices of consumer-finance violations into receivership, but the measure nonetheless also appears to give regulators the option instead of only sanctioning senior officers or directors, constraining business lines, or putting a banking organization or specific entities within it into conservatorship. The drafting is also uncertain as to whether only offenses prior to enactment are covered or if regulators would have this life-or-death power for future transgressions. The statutory drafting in the bill is more clear in its intent to hold senior officers and directors liable for imprisonment if they do not undertake extensive personal review of many very detailed consumer-financial issues. Whether it is in fact feasible to hold individuals criminally liable for what would otherwise be civil violations is at best uncertain.

The findings in the bill assert that all it does is use authority in current law that allows regulators to shutter a banking organization in the service of preventing further consumer harm. However, current law in fact does not give regulators the *carte blanche* afforded in this bill or authorize the CFPB to play any role in franchise decisions of this magnitude. The FDIC may close an insured depository in the event of safety-and-soundness violations, but this is only possible after an extensive set of intermediate actions designed to restore the insured institution to health. Federal regulators can also close an insured depository if it becomes critically under-capitalized or fails to meet anti-money laundering requirements, but significant controls are again in place before such a drastic step. The FRB does not have the authority to close a BHC as this bill would allow despite early-remediation language in the Dodd-Frank Act designed to give it greater authority to force BHCs to remedy safety-and-soundness problems.[1]

However, even if the bill were clear and underlying law less problematic, closing an insured depository or large BHC in the U.S. as the bill demands poses significant stability risk. The measure applies as noted only to GSIBs and these companies are so designated and bear higher regulatory costs due to the greater negative externalities of their demise. The bill would in fact make these risks worse by making the potential of GSIB receivership public well ahead of a final decision and limiting what regulators could do with the assets in a shuttered GSIB following consumer-protection sanction. Only a limited class of acquirers could assume the assets of the shuttered bank, sharply limiting the market for them and significantly raising the risk that a receivership would cost the FDIC considerably more and put uninsured depositors, communities, and counterparties at far greater risk. Ironically, bankruptcy resolution (not OLA) might be more feasible, but this would occur only if markets reacted (as they likely would) to growing charter-termination risk by moving all of their qualified financial contracts to other financial institutions, perhaps selecting those outside the U.S. to avoid any contagion risk in this nation. The end of a GSIB's ability to engage in the businesses for which QFCs are critical would of course hasten its demise even if regulators ultimately decided not to shutter it or to use any of the flexibility that the legislation affords.

What's Next

H.R. 3937 was introduced on October 4. There is no companion Senate legislation. As noted, the measure is unlikely to advance as is under current circumstances.

1 See **SYSTEMIC55**, *Financial Services Management*, January 18, 2012.

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The bill appears to mean that consumer violations that trigger charter revocation would have to occur in the ten years prior to enactment. Violations after enactment might not do so, but the legislation is unclear here since charter revocation could be triggered by activities in which a company "is engaging" even though the "pattern or practice" finding on which charter revocation is premised is drafted in a retrospective fashion. Charter-revocation decisions would need to begin ninety days after enactment although the bill elsewhere allows certain regulatory decisions to be delayed until one year after enactment.

Analysis

Given the length and often confusing nature of this legislation, the analysis below highlights the most important impact issues. In general, all of the provisions described below would apply only to GSIBs whether designated by the FRB[2] or global regulators[3] at the date of enactment. Activities subject to charter revocation for foreign GSIBs cover IHCs, branches, agencies, and other affiliates and subsidiaries subject to the U.S. banking agencies. The scope of possible charter revocations for U.S. GSIBs is similarly expansive but appears to be focused on subsidiary insured depository institutions.

A. Definitions

Key definitions include:

- A "pattern or practice" of unsafe or unsound banking and other violations related to consumer harm means engaging during the ten years prior to enactment in unsafe sales practices and sales-practice oversight (with language here clearly aimed at Wells Fargo); an unsatisfactory consumer-complaint monitoring system; performing unauthorized credit inquiries; poor vendor oversight or a lack of policies related to personal data transfers to third-party vendors; violating an array of consumer-protection laws related to mortgages (with certain activities cited here likely also aimed at Wells Fargo); engaging in unsafe or unsound mortgage servicing; and violating laws related to service members. This section is complex and overlaps with other "pattern and practice" definitions related to consumer laws. As drafted, regulators would be authorized to shutter a bank even if there were no violations if internal policies and procedures did not pass supervisory muster.
- A "pattern or practice" of violations of consumer-protection laws means any of the above as well as anything the CFPB in consultation with federal banking agencies, defines by regulation. The timing of this definition

[2] See **GSIB7**, *Financial Services Management*, July 23, 2015.
[3] See **CAPITAL180**, *Financial Services Management*, November 16, 2011.

appears inconsistent with the prior pattern-or-practice one, but rules on it would need to be issued by the CFPB no later than one year after enactment.

B. Charter Revocation

Notably, the actions below could be executed by regulators without a quorum of applicable members regardless of any other provisions of law if a majority of members concur with the need to act. This could arguably authorize the FRB or FDIC under a Democratic head with a majority of sympathetic members to take the actions described below. A quorum would clearly be needed under current agency configurations and is most unlikely. Under a series of procedures and without necessarily actually finding specific violations, the federal banking agencies would need to determine that the aforesaid patterns or practices have occurred and then initiate proceedings to revoke a GSIB charter absent a counter-finding that continuing the operation is in the public interest or serves important community needs. The CFPB would need to be consulted by a banking agency undertaking this process and the Bureau could also inform the banking agencies that it believes that a banking organization has violated these requirements and warrants revocation. If the Bureau makes such a recommendation, then the agencies must consider it and respond in writing on their planned course of action. Congress would need then to be notified and other procedures, including public hearings and judicial review, would apply.

Charter revocation could mean simple termination of a charter – presumably leaving a company such as a BHC intact but for its ability to own an insured depository should the agencies have decided not to put subsidiary banks into receivership. Charter revocation for an insured depository could also mean simply revoking authority to offer FDIC insurance or borrow from the FRB, but in practice this would trigger the receivership also authorized by the legislation. In these involuntary receiverships, the FDIC would be barred from transferring assets to any banking organization that failed to earn a satisfactory CRA rating or to another GSIB regardless of its CRA rating. Asset transfers also could not be made to any banking organization with problematic consumer-finance practices as apparently could be determined by an array of factors regardless of the company's failure otherwise to trigger charter revocation. As noted, how systemic risk would be handled in any such cases is left more than unclear. The bill also mandates removal of directors, officers, and others involved in the pattern or practice in concert with charter revocation, although the effect of this is unclear since the institution itself would be dissolved. Additional enforcement penalties for culpable directors and officers are also mandated (e.g., a ban on future service in these capacities).

Despite all the provisions summarized above, the legislation includes a separate section that authorizes the following actions in case of a pattern-or-practice filing under procedures also detailed in the bill that appear to provide for other enforcement penalties without charter revocation:

- senior officer or board removal;
- business-line restrictions; or
- initiation of a conservatorship, not a receivership.

C. Board and Senior Officer Requirements

Each executive officer and board member of all GSIB entities would need annually to certify to primary regulators, the CFPB, and law enforcement that he or she regularly reviews business lines and conducts due diligence on internal controls to ensure compliance with all applicable consumer-protection laws. This certification would also have to indicate that the filer knows that the institution has promptly disclosed all identified consumer-law failings to the CFPB and banking agencies, that it is taking steps to remedy all identified problems, that the entity is in compliance with all applicable laws as determined in all prior examinations, and – despite what would seemingly be a certification to this effect from all of these requirements – also that the entity is in full consumer compliance. The CFPB would issue rules on this certification process in consultation with the primary regulators. The bill also includes significant fines for the officers and directors acting in their personal capacity or even imprisonment for deficient certifications. It is not clear which regulator makes this important finding.

In addition, the bill mandates personal money penalties or imprisonment and other sanctions for any consumer violations at an institution under the executive officer or director if the violation enriches the individual and is found to be an unsafe-and-unsound practice. Unsurprisingly, these officers or directors would also have to be terminated and barred from serving in similar capacities.