Financial Services Management

Social-Impact Lending Restrictions

Cite
OCC, Notice of Proposed Rulemaking, Fair Access to Financial Services

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Impact Assessment

- Overall bank credit and service availability could be reduced or altered due to burden and/or the challenges of making the findings required by the OCC.
- Start-ups, innovative entities, and businesses deemed critical to local markets without extensive financial histories could be denied service because other customers not clearly risky using quantitative indicators would be entitled to "proportionate" pricing and other terms unless the bank could determine a way to document and quantify credit- or service-worthiness to only some new or essential-service customers to the OCC's satisfaction.
- Non-quantifiable criteria – e.g., judgments of corporate culture, willingness as well as ability to repay -- would be banned, as would an array of nonquantifiable business factors – e.g., a bank's desire to enter a new market – often key to lending and other financial-service availability, term, and pricing decisions.
- COVID-recovery lending and service availability could be endangered due to the challenges of documenting non-quantitative judgments of a struggling business' or individual's ability to meet its obligations.
- The ban on "geographic redlining" could force banks to take hard-to-quantify climate risks.
- Decisions on capital-markets and other exposures based on a trader's or bank's judgment of market sentiment, future sovereign debt capacity, and other factors would be banned.

Overview

Following through on one of his pledges, Acting Comptroller Brooks' agency has issued a controversial proposal to prevent large banks and perhaps all federally-chartered ones from deciding whether or not to grant credit on grounds other than clear, quantitative indicators of ability to repay. The rule would also force national banks and FSAs to provide any other financial service they offer to a legal business

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unless they can prove that "proportionate" pricing and availability is not necessitated by objective factors in their operating plan. This policy would fundamentally alter the longstanding practices of large and even small federally-chartered banks. Because of the controversial nature of this proposal, it may be hard for Mr. Brooks to finalize it before the Biden Administration takes over the leadership at the OCC. Even if it is finalized, enforcement actions would be difficult to conclude and legal challenge to the rule is likely and also challenging to conclude prior to a policy shift.

Impact

Although in some ways akin to the Department of Labor's recent ruling barring ESG-focused pension investments absent a clear showing of financial benefit,[1] this proposal is based on the OCC's view that financial institutions should not allocate resources based on criteria other than a strict reading of what constitutes appropriate financial risk and return not with an eye to investors, but instead to bank customers. The OCC reads its duty as ensuring "fair access" to financial services and fair customer treatment under the Dodd-Frank Act[2] as creating a right of bank customers, whether or not they are natural persons, to obtain financial services based on "individual circumstances," not on membership in a particular customer category. However, this anti-discrimination standard is conventionally understood to bar discrimination against natural persons or businesses based on the race, gender, religion, disability, or other protected basis of the individual or that projected by a lender to a business based on the business' owners, customers, or purpose – not as a right to credit or services if a seemingly like-kind or even identical business entity in a different line of business also obtained them unless the differentiation is conventionally discriminatory. The OCC's proposal would thus effectively mandate lending and services to businesses as long as they are legal and the bank cannot document an objective service or credit denial reason, adopting by rule a standard Senate Republicans have proposed to implement via pending legislation to protect firearms manufacturers and certain other lines of business.[3]

In the case of this proposal, the OCC is offering no guidance as to any business category it thinks large banks have targeted. However, it does cite a letter from Alaska's Congressional Delegation taking particular issue with the decision by some large banks to eschew financing for new Arctic oil-and-gas drilling projects. The OCC does agree that climate change is a "real risk," but it disputes the extent to which banks are able to make informed judgments about how best to mitigate it. As a result, the proposal's implication is that banks must make loans or provide services to fossil-fuel projects unless they can objectively document a quantitative reason not to do so for one or more borrowers. The agency also notes that balancing climate risk versus the need of economies for employment or the nation for energy is a decision for Congress and energy regulators.

The OCC also asserts in this proposal that what it describes as recent category-based risk judgments are due to political advocates. Targets for lending restrictions said to be pressed by these advocates include family-planning organizations, private prisons, firearms manufacturers, certain ATM and cash-settlement providers, and

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[1] See **ESG2**, *Financial Services Management*, November 9, 2020.

[2] See **CHARTER21**, *Financial Services Management,* August 2, 2010.

[3] See **SOCIALIMPACT**, *Financial Services Management*, April 5, 2019.

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large farming operations. The NPR also asserts that industries essential to local and national infrastructure – e.g., fossil-fuel entities – have been "cut off" from financial-service access. These decisions are, the OCC asserts, due to factors such as the personal or political preference of bank executives, often without making even an effort to price perceived risks. That decisions to curtail financing are not, the agency says, limited to lending demonstrates that considerations are political, not financial.

The agency also argues that fair access should be broadly construed because this was in fact stipulated in a 2014 OCC policy.[4] However, that policy was expressly aimed at money-services businesses (MSBs) not due to personal banker opinions or customer pressure, but because banks feared that the category of MSBs as a whole came under strict anti-money laundering rules and thus posed undue money-laundering risk. As a result, in this instance, as this NPR makes clear, the OCC changed its supervisory guidance and thus facilitated the ability of banks to make MSB-specific risk judgments.

Similarly, another precedent cited by the agency – bank reluctance to provide services to foreign correspondent banks – was also addressed by agency action clarifying its own rulings, not the broad injunction included in it stipulating customer – not category – risk underwriting. "Operation Chokepoint," cited as another example of improper bank discretion, was in fact a federal-government initiative aimed at targeted lines of business, not a set of ESG goals established by one or more large banks.

As noted below, the rule proposed here would directly apply only to large national banks and FSAs based on the OCC's view that these organizations exercise the greatest economic power and are most likely to receive favored federal treatment during periods of stress. However, the proposal does not make it clear if smaller companies would be free to make lending or financial-service access decisions that the OCC did not feel warranted by quantitative rationales. As the agency states, "If a covered bank offers cash management services or commercial lending and specifically provides such services to a large retailer, the bank would be required to offer such services to any other lawful business (e.g., an electric utility or a family planning organization) on proportionally equal terms." The manner in which the bank would document that such widely varying customers present like-kind risks that warrant like-kind access is not made clear.

What's Next

This NPR was released on November 20; comment is due by January 4. This gives the OCC under Mr. Brooks time to finalize it unless the Administration makes personnel change at the OCC an urgent priority and is able to accomplish it under various statutory constraints. However, a rule finalized very quickly could be subject to legal challenge solely on that ground, let alone the others on which banks fearful of significant interruptions to ordinary business practices or new forms of political risk

[4] See **RISKMANAGEMENT11**, *Financial Services Management*, September 16, 2014.

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might undertake. If Democrats gain Senate control, the rule is also likely to be reversed under the Congressional Review Act.

Analysis

The proposal is not intended to affect antitrust considerations, although the OCC says that it is in part predicated on antitrust policy, making its goals here less clear.

A. Covered Banks

Those presumed not to have the ability to direct financial-services access are those with assets below $100 billion. However, as noted, smaller banks governed by the OCC might still be subject to sanction. Covered banks may submit filings to the agency rebutting presumptions that they exercise the economic power on which the rule's restrictions are premised. Comment is sought on an additional approach based on national market share as well as size, with views also requested on the asset-size threshold.

B. Requirements

For a covered bank's board and its management to carry out their core risk management responsibilities, the rule would require them to provide fair access to the bank's financial services with relevant risks quantified and managed, including through pricing. The board and management would ultimately be responsible for ensuring that the bank's operations are consistent with its obligation to provide fair access to financial services including through established written policies and procedures. Based on these, it should be clear whether the bank is providing access to financial services due to "quantitative, impartial risk-based standards." In addition, banks would need to:

- make each financial service they offer available to all persons in their geographic market on "proportionally equal terms;"
- not deny any natural or corporate "person" a financial service otherwise offered by the bank except to the extent justified by the customer's "quantified and documented" failure to meet quantitative, risk-based standards established in advance. The rule would also include an express prohibition against denying financial services based on the "opinion" of the bank or its employees or customers of the person or the person's legal business. However, the bank may take into consideration legal compliance and safety and soundness, considerations on which opinions would presumably be allowed although the rule does not make clear how this might be done or if the documentation and quantification requirements would nonetheless apply;
- not deny any person a financial service the bank offers when the effect of denial is to prevent, limit, or otherwise disadvantage the person from entering or competing in a market or business segment or to benefit another person or business activity in which the covered bank has a financial interest; and
- not deny, in coordination with others, any person a financial service offered by the bank.

The rule would also bar "geography-based redlining," said to be the practice of denying service based solely on where the entity resides, as long as that location is within the bank's overall service area. A bank could deny access to certain services it does not

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offer, but if it offers services such as asset-based lending in some sectors where risks do not materially differ based on the sector, then the bank would need to make that service available on proportionate terms to any person seeking it within the bank's geographic footprint.

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