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5 Predictions For Banking Regulation In A Biden Presidency

By **Jon Hill**

Law360 (November 8, 2020, 5:19 PM EST) -- The regulatory landscape facing banks and other lenders has shifted with Joe Biden's apparent victory in the U.S. presidential election, bringing with it what financial services attorneys predict will be a greater focus on economic inequality and consumer protection, even as the pandemic's economic fallout is likely to continue dominating the agenda.

Biden won the presidency Saturday with his apparent victories in Pennsylvania and Nevada. While President Donald Trump is continuing to fight the results in court, the former vice president said he was moving forward with his transition plans.

Biden will enter the White House in the shadow of a crisis, much as he did in the wake of the 2008 financial meltdown that felled Wall Street giants and led to the creation of a vast new financial regulatory framework. This time he will confront a novel coronavirus pandemic that has killed more than 230,000 in the U.S. alone, threatened millions of businesses with closure and put the banking system through its greatest strain since the financial crisis.

While financial regulation wasn't a defining issue of his candidacy the way it was then, Biden is expected to pivot from the rule rollbacks favored by the Trump administration and push for stronger oversight of financial firms, greater public sector involvement in providing financial services and increased emphasis on economic justice.

At the same time, the incoming administration will assume responsibility for shepherding banks through the COVID-19 crisis and confronting the regulatory challenges posed by the rise of fintech.

"For the most part, I think we're headed more in the direction of a sea change than gradual change," Scott Pearson, a financial services partner at Manatt Phelps & Phillips LLP, said of the post-election financial regulation outlook. "I think there is some possibility that Biden won't be as progressive as some people think, and Republican Senate control would limit what he can do, but we probably are looking at major changes in regulatory policy."

Here, Law360 looks at five predictions of what financial services companies can expect during a Biden administration.

A New CFPB Director

Come January, Biden will have the opportunity to immediately begin reshaping financial regulation by installing new leadership at the Consumer Financial Protection Bureau, which has been instrumental in advancing industry-friendly policies during the Trump administration that have infuriated Democrats and consumer advocates.

The rumor mill surrounding the CFPB's top slot has grown particularly active since the U.S. Supreme Court ruled earlier this year that presidents can freely fire the agency's sole director, a position now held by Kathleen Kraninger, a Trump appointee.

Biden will be under pressure from progressives to name a replacement who follows in the footsteps of the agency's first permanent director, Richard Cordray, who garnered a reputation for aggressive enforcement and rulemaking that rankled many in the financial services industry. Indeed, a recurring theme of the recommendations from the Biden campaign's unity task forces with supporters of Sen. Bernie Sanders, I-Vt., was the need to "reinvigorate" and "strengthen" the CFPB to crack down on high-cost credit and lending discrimination.

Given that Democrats were unable to secure a solid Senate majority, Biden will face an uphill battle getting a CFPB director confirmed who hews closely to the Cordray mold. But even so, financial services attorneys said they haven't yet seen a consensus pick emerge.

Among the names floated in recent weeks have been a number of former CFPB officials, including outspoken law professor Christopher Peterson, who on Tuesday lost his bid to become Utah's first Democratic governor since the 1980s.

Other names viewed as potential candidates include people currently in government like U.S. Rep. Katie Porter, D-Calif., who won re-election Tuesday and has made waves with her fierce questioning at House Financial Services Committee hearings; Federal Trade Commissioner Rohit Chopra; and Patrice Ficklin, who heads the CFPB's fair-lending office.

An Increase in Fair-Lending Enforcement

Federal law prohibits discrimination in lending on the basis of race, gender and other protected characteristics, but Democrats and consumer advocates have accused Trump-appointed banking regulators of failing to adequately enforce these laws, pointing to a decline in fair-lending cases brought by the CFPB and other agencies in recent years.

Concerns about lending discrimination have taken on added salience in the wake of this past summer's national protests over police brutality and systemic racism, while the pandemic's economic toll on nonwhite communities, which have seen disproportionately higher rates of joblessness and business closures, has further heightened awareness of racial disparities in economic opportunity.

To that end, Democrats have pledged to crack down on discriminatory lending practices and turn up scrutiny of fair-lending and fair-housing compliance. The CFPB, for example, may move to reverse a 2018 reorganization that stripped the agency's fair-lending office of its enforcement powers, and rules under laws like the Home Mortgage Data Act and Equal Credit Opportunity Act could be revisited.

"I think everything will be on the table," said Tony Alexis, a partner in Goodwin Procter LLP's financial industry practice who headed the CFPB's enforcement office from 2015 to 2017. "There are a number of aspects to fair lending that do not yet have a firm regulatory backing or basis, so there may be some thought given toward tweaking or rewriting existing regulations."

The CFPB is also expected to draft rules in the coming months that will require financial institutions to report information on their lending to small businesses. Although those rules may take two or more years to finalize and go into effect, they will generate data that could lead to new fair-lending cases.

Beyond the CFPB, other federal banking agencies will be watching closely for bias in lenders' pandemic-response efforts, not to mention the more traditional forms of redlining and unfair discrimination that are policed in tandem with what will become Biden's U.S. Department of Justice.

"Racial justice is going to be one of their biggest priorities," Pearson said of the new administration. "You will see much more aggressive fair-lending enforcement, and it's quite possible you'll see a lot of fair-lending rulemaking, too."

A Different Approach to Tackling Access Gaps

The Federal Reserve made waves last year when it announced plans to build its own real-time payments system, in part because this service would compete directly with the privately owned and operated faster-payments platform that's already up and running called the RTP, or Real Time Payments, network. The Fed's system, by contrast, won't be ready for a few more years.

But Democrats have floated taking government further into competition with financial services providers as a way to bring more underbanked and unbanked consumers into the banking system. The Biden-Sanders task forces, for example, called for supporting legislation to authorize postal banking, to offer "affordable" consumer bank accounts at the Fed and to create a public credit reporting agency at the CFPB as an alternative underwriting resource.

Those ideas face strong opposition from Republicans and the financial services industry, which sees a potential for government overreach and argues the private sector is better positioned to reach underbanked and unbanked consumers through innovation. Without firm Senate control, Democrats will likely have to keep their proposals on the back burner for now.

Still, attorneys said Biden's administration could seek to give financial inclusion a boost from the CFPB by clamping down on overdraft fees and expanding on efforts to encourage small-dollar lending by banks, though the latter would likely come with more prescriptive interest rate limits and other restrictions to mollify consumer advocates.

Biden will also have the opportunity to replace Brian Brooks as head of the Office of the Comptroller of the Currency, which has been pushing a controversial "modernization" of its community lending and investment requirements for federally chartered banks. Critics on the left have charged that the OCC's overhaul will worsen disparities in credit access for lower-income areas, but Senate Republicans thwarted an attempt by Democrats to block the changes legislatively last month. Under Biden-appointed leadership, however, the agency could alter course on the overhaul or scuttle it altogether.

"That's very much a Republican initiative," Pearson said of the revamp. "There's some bipartisan support for it, but generally, I think that's pretty much dead under a Biden administration."

Grappling With the Rise of AI

With more banks and nonbank lenders seeking to deploy alternative data sources and machine learning in lending, Covington & Burling LLP partner Eric Mogilnicki said the Biden administration will have a unique opportunity to address growing frictions between those new technologies and decades-old regulatory frameworks around consumer credit underwriting.

Unless that opportunity is seized, these frictions could impede the financial services industry's adoption of artificial intelligence in lending, cutting short its potential to make affordable credit available to a broader range of borrowers than has been possible with traditional underwriting techniques, according to Mogilnicki.

"These new technologies are like the advent of the automobile, in that you need both highways to make them work and speed limits to make sure they work safely," Mogilnicki said. "I think there is an approach that will allow for innovation and consumer protection at the same time."

Covington recently worked with the Bank Policy Institute, an industry group whose members make the majority of loans in the U.S., on a white paper that called on the CFPB, OCC and other federal banking regulators to foster lenders' "responsible use" of machine learning and other forms of artificial intelligence by undertaking a "principled modernization" of current regulations and guidance.

Under existing fair-lending rules, for example, lenders must explain their reasons when denying a borrower's application for credit, but an AI-powered underwriting engine might base its creditworthiness decision on unconventional data correlations that don't align with conventional denial notices, may not be familiar to borrowers and may require new types of disclosures, according to the white paper.

Because of their ability to chew through vast quantities of constantly changing data and update their decision-making accordingly, AI-powered underwriting engines are also likely to be more dynamic than existing models.

"You would be disappointed in an AI system that turned out the same results in December as in January, because that system had a whole year to learn more about consumer habits and creditworthiness," Mogilnicki said. "But the current regulatory approach to credit models would consider AI to be a failure because it wasn't consistent over time. That's just one way of thinking that has to change if we're really going to embrace AI as a way to assess creditworthiness."

During the campaign, Biden didn't stake out a position on how AI in financial services should be regulated, and some progressives have warned the technology can extend patterns of discrimination through hidden biases baked into large data sets. But Mogilnicki said the industry's growing interest in AI means the issue is one that regulators will inevitably have to confront, and it could provide the new administration with a way to advance its goal of increasing financial inclusion.

"Unlike so many things in Washington these days, this is a place where there doesn't have to be a partisan divide, and there are opportunities to find a solution that works for everyone," Mogilnicki said.

Don't Hold Out for Overnight Action

Biden might be able to install new leaders at some of the financial regulators, but much of the regulatory apparatus will remain stocked with Trump appointees for the time being. Federal Reserve Chairman Jerome Powell's term doesn't run out until 2022, for example, and Federal Deposit Insurance Corp. Chairwoman Jelena McWilliams has said she plans to stick around until her term expires in 2023.

"I was appointed to a five-year term, and I will fulfill as much of it as I'm allowed to," McWilliams told a bankers conference last month. "There are a number of things that we can continue working on, regardless of how the political winds shift."

As a result, the new administration's regulatory agenda will likely be slowed until more of its appointees are in place, which could take a while in a Republican Senate.

But attorneys said a more fundamental obstacle to policymaking will be the COVID-19 crisis. As loan forbearances and other pandemic-relief measures start to roll off at the end of this year and as the economy continues to limp along, banking regulators will have their hands full ensuring the integrity of the financial system.

"Interest rates are artificially low right now, and they likely are going to stay that way for a really long time. That puts a lot of pressure on financial institutions," Pearson said. "I think there will be some serious safety and soundness issues coming out of that that regulators will have to reckon with."

Alexis agreed that nursing the economy back to health is likely to remain regulators' overarching priority in the near term.

"What is important right now is getting the economy going," Alexis said. "The regulatory regime will want to be having people with monetary policy, fiscal policy and consumer policy [expertise] sitting down and coordinating their efforts to make sure that they can get the economy going again."

Still, Michael Gordon, a Bradley Arant Boult Cummings LLP partner who was on the startup team that formed the CFPB, said the severity and urgency of the pandemic's economic damage could yet reach a pitch where political paradigms shift, creating room for more progressive consumer financial policymaking than might have otherwise been feasible for a Biden administration.

"Widespread hardship can boost reform efforts, as we saw with the financial crisis and the passage of [the Dodd-Frank Act]. You can imagine congressional hearings and even regulatory actions that highlight stories of hardship caused by the COVID crisis," Gordon said. "Compelling stories can focus attention on consumer protection issues and help build support for reforms that [Democrats] have wanted all along."

--Editing by Breda Lund and Alyssa Miller.