International banking: A look back at 2020 and a preview of 2021

Kathleen A. Scott, *New York Law Journal* — January 12, 2021

Looking back at 2020

Federal Reserve Board's "control" regulations: In January 2020, the Federal Reserve Board issued its long-anticipated final regulations clarifying and simplifying the standards under which one company controls a banking organization or another company. Previously, the Federal Reserve Board had developed general standards that were used to evaluate situations that fell outside of the statutory definition of control in the Bank Holding Company Act. The final rule divides the analysis of whether control exists in a particular situation into three sections, depending on ownership of 5% or more, 10% or more, or 15% or more, of the outstanding securities of any class of voting shares by one company of a second company. At each such ownership level, there is a list of additional factors that need to be considered in order to determine whether there is control. The rule was effective on April 1, 2020.

Volcker Rule regulations: In 2019, the proprietary trading regulations of the Volcker Rule were revised. In July 2020, final regulations to amend the private equity funds investment/sponsorship prong of the Volcker Rule regulations were issued by the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Commodity Futures Trading Commission and the Securities and Exchange Commission (SEC) (collectively, the Agencies). As with the proprietary trading final rule, the stated purpose of the revisions was to clarify and simplify compliance with the Volcker Rule. The private equity funds revisions refined the extraterritorial application of the Volcker Rule by incorporating an exemption from the Volcker Rule for certain private non-U.S. funds. New exclusions from the definition of "covered fund" also were added for specific types of non-U.S. public funds, particular credit funds that are not otherwise loan securitizations and defined family wealth investment vehicles. For more detail, please see my July 17, 2020 column "Volcker Rule Covered Funds Revisions Finalized: Impact on Non-US Banks." The final rule was effective on Oct. 1, 2020.

OCC national bank and federal branch permissible activities: For those international banking organizations with U.S. national banks chartered by the OCC, or federal branches licensed by the OCC, in December 2020, the OCC issued final regulations revising its regulations on permissible activities, including codifying recent OCC interpretations. Changes include new regulations regarding the circumstances under which national banks and federal branches and agencies can engage in derivative activities and tax equity financing. The final rule is effective on April 1, 2021.

Accredited investor definition: In October 2020, the SEC finalized amendments to the definition of "accredited investor" adding new categories of qualifying natural persons and entities and to make certain other modifications to the existing definition

More than 50 locations, including London, Houston, New York, Toronto, Mexico City, Hong Kong, Sydney and Johannesburg.

Attorney advertising

Reprinted with permission from the January 12, 2021 edition of the *New York Law Journal* © 2021 ALM Media Properties, LLC. All rights reserved.
Further duplication without permission is prohibited. www.almreprints.com – 877-257-3382 – reprints@alm.com.

to allow a greater pool of eligible investors to access the private capital markets. Changes include permitting certain natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials; and adding certain family offices and certain entities organized under the laws of a country other than the United States not formed for the purposes of investing in the securities offered. The definition of "qualified institutional buyer" also was amended to broaden its scope.

Things to look forward to in 2021

Beneficial ownership rule revisions: A section of the Corporate Transparency Act, which is Title LXIV of the National Defense Authorization Act, and became law on Jan. 1, 2021, requires nonpublic companies to report the identities of their beneficial owners to the Financial Crimes Enforcement Network (FinCEN), the U.S. anti-money laundering agency. Under current regulations, AML customer identification requirements require banks and certain other financial institutions opening accounts for entities to obtain beneficial ownership information on individuals owning 25% or more of the entity and also to identify a person with significant control over the entity, such as a president or chief executive officer.

These financial institutions long have felt it was burdensome to have to obtain that information, and new entity customers may be reluctant to provide it. This new reporting requirement puts the reporting onus on corporations, limited liability companies or other similar entities that are established by filing a document (such as articles of incorporation) with a U.S. state secretary of state, Indian Tribe, or similar entities formed under the laws of a foreign country that register to do business in the United States by making a similar filing with a state or Indian Tribe.

There are several exceptions, such as publicly-traded companies, regulated financial services organizations and public utilities. Under the new law, a beneficial owner is an individual who directly or indirectly exercises "substantial control" over the reporting company or owns or controls a 25% or more ownership in the entity (subject to certain limited exceptions)—this is similar to the definition in the current regulation.

The legislation must be implemented by regulations issued by FinCEN, but the statute requires that the following information be reported to FinCEN: full legal name of the individual, date of birth, current residential or business address, and a "unique identifying number" such as a driver's license or passport number, or a "FinCEN identifier," which is a number to be assigned to an individual or reporting company by FinCEN upon request. Other provisions in the new statute include requirements for encryption of data provided to FinCEN and security protocols for sharing of the information with government agencies or a financial institution establishing a new account for an entity. The Treasury Department also is required to prepare materials giving notice of this new reporting requirement to be included with federal tax or FinCEN forms.

FinCEN is required to promulgate the regulations not later than Jan. 1, 2022.

Proposed 36-hour timeline for reporting data breaches: On Dec. 18, 2020, the OCC, Federal Reserve Board and FDIC jointly announced a proposed rule that would require banks to notify their regulators within 36 hours of a "computer-security incident" that rises to the level of a "notification incident."

The proposed rule also would require bank service providers, such as those providing data processing, to notify at least two individuals at their affected bank customers immediately after it experiences a computer-security incident that it believes in good faith could disrupt, degrade, or impair services provided to the bank customer, for four or more hours They are not required to report these incidents directly to the regulators of their bank customers.

A "computer-security incident" is proposed to be defined as "an occurrence that (i) results in actual or potential harm to the confidentiality, integrity, or availability of an information system or the information the system processes, stores, or transmits; or (ii) constitutes a violation or imminent threat of violation of security policies, security procedures, or acceptable use policies."

The proposed definition of a "notification incident" is that a bank believes in good faith that a computer-security incident could materially disrupt, degrade, or impair the bank's ability to carry out its operations in the ordinary course of business; or that a specific business line at the bank could result in a "material" loss of revenue, profit or franchise value; or the failure or discontinuance of the affected bank's operations would "pose a threat to the financial stability of the United States."

Examples of reportable incidents described in the regulations include a failed system upgrade or change that results in widespread user outages for customers and bank employees; a computer hacking incident that disables banking operations for an extended period of time; or a ransom malware attack that encrypts a core banking system or backup data.

The 36-hour clock starts when the bank determines that a notification incident has occurred. There is no specific format in which the information is to be reported, nor by which means notice can be provided, which even could be by email or telephone. The information reported to the regulators would be considered confidential.

Once formally published in the Federal Register, the comment period will be open for 90 days.

LIBOR termination: The London Interbank Offering Rate (LIBOR) is used as a standard reference rate for various financial transactions such as loans and derivatives. As every banking organization should know, in 2017, the UK Financial Conduct Authority, the regulator that oversees the setting of LIBOR, announced that LIBOR and the other interbank offering rates (IBORs) might be phased out after 2021.

Since then, global efforts have been made both to develop a new standard reference rate going forward, as well as dealing with all current financial transactions tied to LIBOR and the interbank offering rates offered in other currencies. The alternative rate in the United States that has been chosen in many circumstances is SOFR, the Secured Overnight Financing Rate that has been proposed by the Alternative Reference Rate Committee (ARRC), a group of banks and banking regulators formed by the Federal Reserve Bank of New York. SOFR is comprised of three overnight U.S. Treasury repurchase rates. Variants of SOFR have been developed for use in different situations, including various types of loans (including consumer loans), derivatives and securitizations.

Alternatives also are available, including the federal funds rate, and a group of primarily non-money market banks have developed its own alternative rate, called Ameribor. While SOFR is a backward-looking index, Ameribor is a forward-looking index that reflects the actual borrowing costs of thousands of small, medium and regional.

The banking regulators have been warning banks operating in the United States for some time that they should be planning for the transition away from LIBOR. On July 1, 2020, the Federal Financial Institutions Examination Council (FFIEC), which consists of U.S. federal and state banking regulators and the Consumer Financial Protection Bureau, issued a Joint Statement highlighting the possible risks that banks need to take into consideration while working on their respective LIBOR transition plans. Banks are expected to have risk-based processes in order to identify and mitigate the risks their respective institutions face in planning for the discontinuance of LIBOR as a reference rate.

Banking regulators continue to emphasize the need for banks to be prepared. On Nov. 6, 2020, they issued a statement reminding banking organizations that new contracts should either contain a new reference rate other than LIBOR or contain fallback language that includes a clearly defined reference rate for use after LIBOR is discontinued. The Agencies made it clear in that statement that they are not endorsing one specific replacement rate for LIBOR over another.

Recently, the administrator of LIBOR, the ICE Benchmark Administration Limited (IBA), requested feedback on a decision to cease publication of the overnight, one-, three-, six- and 12-month LIBOR. The previous expectation was that publication would stop at the end of 2021. It now appears that IBA will cease publication of these tenors in June 2023, while they will plan to cease publication of one-week and two-month LIBOR at the end of 2021. The banking regulators quickly issued a joint statement praising the extension to June 2023, which they state will provide legacy LIBOR contracts more time to mature.

Conclusion

As noted above, it looks like the year 2021 may be a busy year for bank regulation. In addition, a new president will be inaugurated on Jan. 20, 2021, and there is much speculation as to what a Biden administration will do in the area of financial services regulation. Some of the subjects in the banking area that people have mentioned include consideration of climate change risk, a rollback in the deregulation of CFPB rules done by the Trump administration, and giving banks a safe harbor for servicing cannabis businesses in states where cannabis has been legalized. At this point, only time will tell.

Kathleen A. Scott is senior counsel at Norton Rose Fulbright in New York.

NORTON ROSE FULBRIGHT

Law around the world

nortonrosefulbright.com

© Norton Rose Fulbright US LLP. Extracts may be copied provided their source is acknowledged.
#####_US – 01/21