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CABINET NEWS

Research and commentary on regulatory and other financial services topics

Deck the Halls, But Mind the Regulations

December 19, 2024

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How Trump's Favorite Law Could Roll Back Recent Financial Regulations

December 19, 2024

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The Congressional Review Act ("CRA") is an interesting law that we really only think about when there is a change of party affiliation of an incoming President. Effectively, the CRA allows Congress to overturn rules that have been put into place during the 60 legislative days prior to the change of administration. Passed in 1996 to allow Congress to better police federal agencies, the CRA applies to final rules, but also could apply to "agency actions that are not subject to traditional notice-and-comment rulemaking, such as guidance documents and policy memoranda." (See **The Congressional Review Act ("CRA"): A Brief Overview by the Congressional Research Service, last updated August 29, 2024**).

Prior to the first Trump administration, Congress had only agreed to a "joint resolution of disapproval" and overturned a final rule once. But, Trump's administration used it sixteen times during the 115th Congress (i.e., when both houses were Republican), which makes the CRA seem like one of Trump's favorite laws. **Based upon letters sent out by the current Chairman and the incoming Chairman of the House Committee on Financial Services to financial regulators on December 17th**, it seems as though we can expect the new Trump administration to encourage the Republican majority Congress to use the CRA to pursue overturning even more final rules. When Congress issues a joint resolution of disapproval, then the rule is immediately ineffective, if already in effect, and it is as though the rule never went into effect. If the rule was not yet in effect, then the rule never goes into effect. Further, such a rule "may not be reissued in substantially the same form, and a new rule that is substantially the same . . . may not be issued, unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution." (See **CRS report**)

The letters were sent to all of the following: the Department of the Treasury ("Treasury"), the Department of Housing and Urban Development ("HUD"), the Securities and Exchange Commission ("SEC"), the Federal Reserve Board ("Fed"), the Federal Deposit Insurance Corporation ("FDIC"), the Consumer Financial Protection Bureau ("CFPB"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Housing Finance Agency ("FHFA"). Similar in form, each letter cautions the agencies "against finalizing partisan rulemaking over the next several weeks," references the CRA and then states, "the financial system, its institutions, consumers, and the [agency] itself do not benefit from last-minute partisan rulemaking attempts."

Counting back 60 legislative days puts rules and guidance issued as far back as mid-August into potential peril. Of course, the prescribed method for obtaining a joint resolution of disapproval under the CRA is not easy and requires careful coordination among the House and the Senate, so even an eager Trump administration, aided by a Republican Congress, will not be able to push through a complete rollback of all rules and guidance issued by federal agencies (i.e., not just financial federal agencies) since August. But, there are some laws issued by financial federal agencies that may be more likely to be rolled back than others. In particular, the CFPB rules addressing **Personal Financial Data Rights** and **Big Tech Supervision** could be candidates for roll back.

Nota bene: The letters to the **Fed**, **FDIC**, **OCC** and the **SEC** all mentioned that the Committee was interested in revisiting investigations into inter-agency coordination on "digital asset custody" issues. Specifically, they want to further address the SEC's publication of **Staff Accounting Bulletin 121** that deals with "obligations to safeguard crypto-assets an entity holds for platform users" and which was published by the SEC in April 2022, despite the fact that the other agencies had been working on an inter-agency statement addressing similar issues. Stating "it is imperative to ensure that no agency undermines another through rushed actions, which risks introducing uncertainty and instability into our financial system," all of this suggests that Congress may be ready to hit the ground running on cryptocurrency issues come January.

The EU Consults on Operating Conditions for Open-Ended Loan Origination Funds

December 19, 2024

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The EU has issued its **consultation on Regulatory Technical Standards** for open-ended loan-originating AIFs operating under AIFMD II.

As previously flagged, the default position under AIFMD II is that Loan Originating Alternative Investment Funds ("LO AIFs") should be closed-ended. However, AIFMD II does allow room for LO AIFs able to demonstrate to the competent authorities of the AIFM's home Member State that the AIF's liquidity risk management system is compatible with its investment strategy and redemption policy to function as open-ended funds. This is dependent on certain categories of systemic controls being met, including: (i) a sound liquidity management system; (ii) the availability of liquid assets and stress testing; and (iii) an appropriate redemption policy having regard to the liquidity profile of LO AIFs. The requirements must also take account of the underlying loan exposures, the average repayment time of the loans and the overall granularity and composition of the portfolios of loan-originating AIFs, reflecting an overall concern with liquidity mismatches currently observed by a number of international regulators.

Requirements for Open-Ended Status for LO AIFs

Overall, the consultation asks 22 questions and sets forth five substantive Articles as follows:

- Article 1: Sound liquidity management: An AIFM must define an appropriate redemption policy and determine an appropriate portion of liquid assets that the relevant LO AIF targets holding.
- Article 2: Appropriate redemption policy: An AIFM must consider the numerous criteria set out, including the frequency of redemptions, the proportion of liquid assets and the portfolio diversification and liquidity profile of the assets.
- Article 3: Availability of liquid assets: In determining the adequate proportion of liquid assets (which cannot be assumed simply by asset type), an AIFM must exercise a prudent approach and consider as liquid the expected cash flow generated by the loans granted.
- Article 4: Liquidity stress tests: An AIFM must conduct liquidity stress tests "at least on a quarterly basis, unless a higher or lower frequency is justified by the characteristics."
- Article 5: Ongoing monitoring: An AIFM must conduct ongoing monitoring of these assessments, which must include early-warning signals of loan impairments which in turn affect the level of leverage.

Next Steps

Responses to the consultation are due by 12 March 2025, and the Commission anticipates finalising the RTS in time for Q3/4 2025.

Update Regarding Nationwide Injunction Pausing Implementation of the Corporate Transparency Act

December 19, 2024

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On December 3, 2024, the U.S. District Court for the Eastern District of Texas issued a nationwide preliminary **injunction** in *Texas Top Cop Shop, Inc., et al. v. Garland*, enjoining the federal government from enforcing the Corporate Transparency Act ("CTA"), its implementing regulations, and its reporting deadlines, and finding that Congress exceeded its authority in enacting the law.[1]

As a result of the decision, reporting companies are not required to comply with the CTA at this time, as the court ordered that "reporting companies need not comply with the CTA's January 1, 2025, [beneficial ownership information] reporting deadline pending further order of the Court."[2]

A FinCEN alert published after the *Texas Top Cop Shop* injunction states that reporting companies will not be subject to liability if they fail to file a beneficial ownership information report while the preliminary injunction remains in effect.[3] FinCEN also stated that reporting companies may continue to voluntarily submit their reports.

The Department of Justice has appealed. On December 13, 2024, the Department of Justice filed an Emergency Motion for Stay Pending Appeal in the Fifth Circuit.[4] The government requested an expedited briefing schedule and a ruling "as soon as possible, but in any event no later than December 27, 2024, to ensure that regulated entities can be made aware of their obligation to comply before January 1, 2025."[5] The government's requested briefing schedule could be read to indicate that the government intends to enforce the January 1, 2025 deadline if the stay is granted. Therefore, reporting companies are well-advised to closely monitor developments in the coming days in case the January 1, 2025 deadline for filing is revived. The Fifth Circuit appears to be accommodating the government's request for a December 27, 2024 ruling; briefing on the Emergency Motion for Stay Pending Appeal is scheduled to be complete by December 19, 2024.[6]

The constitutionality of the CTA has been challenged in several other courts. The issue is on appeal in a separate case in the 11th Circuit, where a federal district court in Alabama also found the CTA unconstitutional.[7] However, in two federal district courts in Virginia and Oregon, courts denied preliminary injunctions after finding that the CTA likely is constitutional.[8] FinCEN's recent alert states, "[t]he government continues to believe—consistent with the conclusions of the U.S. District courts for the Eastern District of Virginia and the District of Oregon—that the CTA is constitutional."[9]

Any decision on the merits may take months or longer, and the matter ultimately may be heard by the Supreme Court. It remains to be seen whether the incoming Trump administration will continue the appeal, but the first Trump administration supported the CTA legislation.

We will continue to monitor developments related to the CTA.

If you have any questions, please feel free to contact **Jodi Avergun**, **Christian Larson** or **Keyes Gilmer**.

1 *Texas Top Cop Shop, Inc. v. Garland*, No. 4:24-CV-478, 2024 WL 4953814 (E.D. Tex. Dec. 3, 2024).

2 *Id*. at *37.

3 *Beneficial Ownership Information*, FinCEN, **https://fincen.gov/boi** (last accessed Dec. 16, 2024).

4 Emergency Motion for Stay Pending Appeal, *Texas Top Cop Shop, Inc. v. Garland*, No. 24-40792 (5th Cir. Dec. 13, 2024), ECF No. 21.

5 *Id.* at 2.

6 Court Directive, *Texas Top Cop Shop, Inc. v. Garland*, No. 24-40792 (5th Cir. Dec. 13, 2024), ECF No. 25.

7 Notice of Appeal, *Nat'l Small Bus. United v. Yellen*, No. 5:22-CV-1448-LCB (N.D. Ala. Mar. 11, 2024), ECF No. 54.

8 Notice of Appeal, *Cmty. Associations Inst. v. Yellen*, No. 1:24-CV-1597 (MSN/LRV) (E.D. Va. Nov. 4, 2024), ECF No. 41; Notice of Appeal, Firestone v. Yellen, No. 3:24-CV-1034-SI (D. Or. Nov. 18, 2024), ECF No. 19.

9 *Beneficial Ownership Information*, FinCEN, **https://fincen.gov/boi** (last accessed Dec. 16, 2024).

Credit Risk Transfers – A Handbook for U.S. Banks

December 19, 2024

Cadwalader, KPMG, and TWK Advisors have prepared **Credit Risk Transfers – A Handbook for U.S. Banks**. This handbook offers an in-depth look at Credit Risk Transfers ("CRTs"), a regulatory capital optimization tool long used by European banks and U.S. non-bank agencies, with new applications emerging for regional and community banks.

As the banking landscape grows increasingly complex, this guide provides essential insights into structuring, pricing, and implementing CRTs, making it an invaluable resource for financial institutions seeking to enhance capital and risk management strategies.

This detailed handbook demystifies the structuring, costs, and regulatory considerations of CRTs, providing a practical guide for banks of all sizes looking to optimize their regulatory capital position. Through an in-depth case study, it offers insights on how even smaller institutions can utilize this important tool.

We also wanted to bring to your attention the excellent and informative paper, "**The Economics of Synthetic Risk Transfers**," by **Francisco Covas** and **Benjamin Gross** of the Bank Policy Institute ("BPI"). Their paper takes a close look at the compelling economics of bank risk transfer transactions, particularly where regulatory capital requirements applicable to a given loan portfolio significantly overstate the portfolio's actual credit risk.

The Whistleblower Rules & Revisiting Confidentiality

December 19, 2024

By Katie McShane
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The Securities Exchange Commission ("SEC") has, in furtherance of its whistleblower program, taken actions recently that have led to lenders updating the confidentiality sections of credit agreements to allow for the disclosure of confidential information by potential whistleblowers. This week, we provide a brief overview of these SEC actions and, importantly, provide sample language that can be used to update confidentiality provisions.

Background

The Dodd-Frank Act added Section 21F to the Securities Exchange Act of 1934, which required the SEC to formalize a whistleblower program and to pay awards to whistleblowers who provide them with original information regarding violations of Federal securities laws. Pursuant to Section 21F, the SEC promulgated the Whistleblower Rules available at ***17 C.F.R. § 21F-1, et seq.*** The Whistleblower Rules, which have been amended in 2018 and 2022, prohibit any person from taking an action to impede a potential whistleblower from communicating directly with the SEC about a possible securities law violation, including enforcing or threatening to enforce, agreements with confidentiality provisions.

Recent SEC enforcement actions have found that various confidentiality provisions breached the Whistleblower Rules, requiring the payment of penalty fines to settle the charges in question. Below we have summarized some recent SEC enforcement actions to illustrate how the SEC has challenged confidentiality provisions, which are often viewed as standard legal language and are rarely changed from agreement to agreement:

- On September 26, 2024, **the SEC announced settled charges against Florida-based GQG Partners LLC**, a registered investment adviser, for entering into standard non-disclosure agreements with candidates for employment and a settlement agreement with a former employee that expressly prohibited them from reporting confidential information to governmental authorities. The SEC found that GQG violated the Whistleblower Rules because the language in the agreements constituted taking an action to impede an individual from communicating directly with the SEC staff about possible securities law violations. Without admitting or denying the SEC's findings, GQG agreed to be censured, to cease and desist from violating the Whistleblower Rules, and to pay a $500,000 civil penalty.
- On September 9, 2024, **the SEC announced settled charges against seven public companies** for using employment, separation, and other agreements to impede whistleblowers from reporting potential misconduct to the SEC, in violation of the Whistleblower Rules. To settle the SEC's charges, the companies agreed to pay more than $3 million combined in civil penalties. The SEC's Chief of Office of the Whistleblower was quoted as saying "*Ensuring that potential whistleblowers can communicate directly with the Commission is a critical part of the SEC's oversight mandate*".
- On September 4, 2024, **the SEC announced settled charges against three affiliated registrants**, Commission-registered broker-dealer Nationwide Planning Associates, Inc. and investment adviser NPA Asset Management, LLC, and state-registered investment adviser Blue Point Strategic Wealth Management, LLC, for impeding brokerage customers and advisory clients from reporting securities law violations to the SEC by allegedly asking these clients to sign confidentiality agreements. The agreements were in connection with payments made by the entities to the clients' investment accounts, which payments were intended to compensate the clients for losses caused by the firms' alleged breaches of federal or state securities laws. The firms agreed to pay combined civil penalties of $240,000 to settle the SEC's charges.

Revisiting Confidentiality

The recent enforcement actions may not obviously point to the need to update confidentiality provisions in other kinds of agreements. But consider that credit agreements require borrowers to deliver a substantial amount of information to lenders, which often includes highly sensitive information. As such, the confidentiality provisions are of utmost

importance to a sponsor when putting a credit agreement in place, since disclosure of the sensitive information could affect their position with customers, employees or competitors. Similarly, lenders need to ensure that they have enough information and flexibility with respect to such information to operate their business and administer the credit being provided appropriately. Having a clear understanding as to what is confidential and what is not confidential also helps the lender with its compliance requirements under securities laws.

Today, confidentiality provisions in credit agreements already typically allow for disclosure to regulators, but such disclosure is usually premised on allowing the disclosure of confidential information in the context of an examination or specific regulator demand. For this reason, we think that it is important to review the confidentiality provisions to ensure that they are written so that they in no way impede potential whistleblowers from disclosing information that would be considered confidential to the SEC proactively. Taking the time to update these provisions actually reduces liability for all of the parties, because any party could be liable for impeding whistleblowers under the Whistleblower Rules. For this reason, making such changes to confidentiality provisions should not be controversial. Below is sample language that we have seen in the market and that lenders have begun to request (and expect):

- ***Sample Language***

"*For the avoidance of doubt, nothing in this Credit Agreement is intended or shall be deemed to prohibit or restrict any Borrower Party or any other person in any way from initiating communications directly with, reporting to, providing information to, causing information to be provided to, filing a charge or complaint with, cooperating with, responding to any inquiry from, or providing testimony to the Securities and Exchange Commission, Commodity Futures Trading Commission, Financial Industry Regulatory Authority, or any other self-regulatory organization, or any other federal or state regulatory authority, or governmental agency or entity, regarding any possible securities violation or other violation of law*."

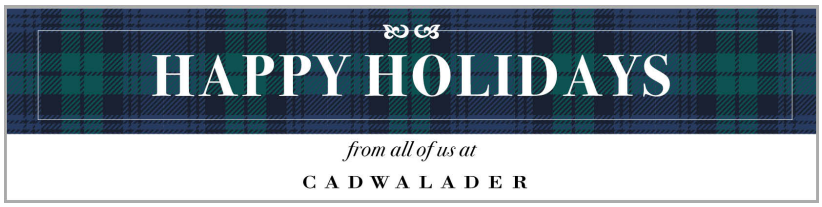
Conclusion

We hope this short article has provided you with a helpful background on the Whistleblower Rules and why you may be seeing redlines of confidentiality provisions in credit agreements. The Cadwalader team remains available to assist with relevant queries.

This article was previously featured in *Fund Finance Friday* **here**.

Happy Holidays From Cadwalader

December 19, 2024



Dear *Cabinet News & Views* readers, as the holiday season approaches, we want to extend our heartfelt gratitude for your continued support and engagement throughout the year.

To celebrate this special time and prepare for an exciting year ahead, we'll be taking a brief pause. *Cabinet News & Views* will return in January, refreshed and ready to bring you more insights and updates.

We wish you a joyous and peaceful holiday season surrounded by warmth, happiness, and cheer and we look forward to reconnecting in 2025!