FEBRUARY 2023 RECAP

Developments to know in Banking, Fintech & Crypto

By Jeff Novel

In traditional banking: (1) FinCen warns of surge in mail theft-related check fraud; (2) The CFPB urges the Supreme Court to review the 5th Circuit's finding that the CFPB's funding structure is unconstitutional; (3) the OCC revises guidance on branch closings and changes of control; and (4) Regulators reinforce the need to act now in preparation for the end of LIBOR.

FinCen warns of surge in mail theft-related check fraud

On February 27, 2023, the Financial Crimes Enforcement Network ("FinCen") issued an alert warning financial institutions of a nationwide surge in mail theft-related check fraud schemes. Mail theft-related check fraud generally pertains to the fraudulent negotiation of checks stolen from the U.S. Mail. FinCen issued this alert to ensure that Suspicious Activity Reports ("SARs") filed by financial institutions appropriately identify and report suspected check fraud schemes that may be linked to mail theft in the United States. The FinCen report provides an overview of the recent surge, highlights select red flags to assist financial institutions in identifying and reporting suspicious activity, and reminds financial institutions of their reporting requirements under the Bank Secrecy Act ("BSA"). Red flags noted by FinCen report include:

- Uncharacteristically large withdrawals on a customer's account via check to a new payee.
- Customer complaints that checks were stolen from the mail and then deposited into an unknown account.
- Customer complaints that mailed checks were never received by the intended recipient.
- Checks used to withdraw funds from a customer's account appear to be of a noticeably different check stock than check stock used by the issuing bank and check stock used for known, legitimate transactions.
- Existing customer with no history of check deposits has new sudden check-deposits and withdrawal or transfer of funds.
- Non-characteristic, sudden, abnormal deposit of checks, often electronically, followed by rapid withdrawal or transfer of funds.
- Examination of suspect checks reveals faded handwriting underneath darker handwriting, giving the appearance that the original handwriting has been overwritten.
- New customer opens an account that is seemingly used only for the deposit of checks followed by frequent withdrawals and transfer of funds.
- A non-customer that is attempting to cash a large check or multiple large checks in-person.

A financial institution is required to file a SAR if it knows, suspects, or has reason to suspect a transaction conducted or attempted by, at, or through the financial institution involves funds derived from illegal activity; is intended or conducted to disguise funds derived from illegal activity; is designed to evade regulations promulgated under the BSA; lacks a business or apparent lawful purpose; or involves the use of the financial institution to facilitate criminal activity. FinCen requests that financial institutions indicate a connection between the suspicious activity being reported and the activities highlighted in its alert by including the key term "FIN-2032-MAILTHEFT" in SAR field 2, as well as in the narrative, and by selecting SAR Field 34(d) (check fraud). Financial institutions need to review their SARs-related policies and update them as needed to address the issues referenced in this FinCen alert.

The CFPB urges the Supreme Court to review the 5th Circuit's finding that the CFPB's funding structure is unconstitutional

The Consumer Financial Protection Bureau ("CFPB") recently filed a reply brief relating to its petition for a writ of certiorari seeking review of the Fifth Circuit decision in *Community Financial Services Association of America, Ltd. v. CFPB*. In that decision, the Fifth Circuit Court of Appeals held that the CFPB's funding structure violates the Appropriations Clause of the United States Constitution and vacated the CFPBs payday lending rule.

In the reply brief, the CFPB challenged Community Financial Services Association of America, Ltd.'s assertion that the CFPB's funding was "unprecedented," noting that the respondents "cannot meaningfully distinguish the CFPB's funding from Congress' longstanding and concededly valid practice of funding agencies from standing sources outside annual spending bills." The CPFB also argued that the Respondents failed to rehabilitate the appellate court's disruptive remedy and could not justify the district court's failure to conduct a severability analysis.

At this time, it is unclear whether the U.S. Supreme Court will review the Fifth Circuit's ruling during the current Supreme Court term or during the next term.

The OCC revises guidance on branch closings and changes of control

On February 7, 2023, OCC Bulletin 2023-6 provided notice of an updated version of the "Branch Closings" booklet of the *Comptroller's Licensing Manual*. According to OCC Bulletin 2023-6, the revised booklet, which outlines policies and procedures for filings and customer notices relating to the closing of all national bank, federal savings associations, and federal branches and agencies of foreign banking organizations, updates guidance, provides current references, and makes other minor modifications and corrections to the previous booklet.

Similarly, on February 16, 2023, OCC Bulletin 2023-7 provided notice of an updated version of the "Change in Bank Control" booklet in the *Comptroller's Licensing Manual*. The revised booklet replaced the same title issued in September 2017, makes corrections where necessary and contains updated guidance for changes of control of national bank, federal savings associations, and federal branches and agencies of foreign banking organizations.

Financial institutions should be aware of the updated guidance provided in these bulletins and confirm compliance with the Branch Closings booklet and Change in Bank Control booklet where appropriate.

Regulators reinforce the need to act now in preparation for the end of LIBOR

USD LIBOR is expected to end on June 30, 2023. In late January, the Alternative Reference Rates Committee of the Federal Reserve Board ("ARCC") published its Summary of Key ARCC Recommendations ("ARRC Key Recommendations") in which it advised:

1. Take action now to remediate legacy contracts ahead of June 30, 2023;
2. Communicate planned rate changes and use the Depository Trust and Clearing Corporation's enhanced Legal Notice System as soon as available to effectively disseminate information on rate changes for securities; and
3. Use the Secured Overnight Financing Rate ("SOFR") as the replacement rate for USD LIBOR and as the basis of the transaction in cash and derivatives markets.

The ARCC Key Recommendations repeated advice from the FSB Progress Report from the end of June 2022 warning that a large number of contracts requiring fallback implementation and/or contract renegotiation will pose operational or market disruption risks. Financial institutions with legacy contracts including LIBOR without fallback provisions should contact counsel now to determine how to best address LIBOR-related issues.

In Fintech & Crypto: (1) Recent crypto settlements point towards enforcement trends relating to staking and earned-interest products; and (2) the SEC puts celebrities on notice regarding crypto endorsements.

Recent crypto settlements point towards enforcement trends relating to staking and earned-interest products

The North American Securities Administrators Association ("NASAA") is an organization of securities regulators consisting of 67 state, provincial and territorial securities administrators. The NASAA recently found that a Cayman Islands digital assets firm, Nexo, violated securities registration provisions through its sale of the Nexo Earned Interest Product. According to the NASAA, Nexo provides virtual currency-related financial services to retail and institutional borrowers in the United States, including trading, borrowing and lending services. The NASAA alleged that Nexo failed to register as a securities and commodities broker but told investors that it was fully in compliance with various securities registration requirements. In late January, the NASAA announced that as part of a settlement, Nexo will pay $22.5 million to settle Securities Exchange Commission ("SEC") charges and $22.5 million in fines to settle similar charges by state regulatory authorities including regulatory agencies in California, Washington, Kentucky, New York, Oklahoma, Indiana, Maryland, South Carolina, Vermont and Wisconsin.

On February 9, 2023, the SEC filed a complaint against Payward Ventures, Inc. and Payward Trading, Ltd., both commonly known as Kraken, for the failure to register the offer and sale of their crypto asset staking-as-a-service program, whereby investors transfer crypto assets to Kraken for staking in exchange for advertised annual investment returns as much as 21 percent. To settle the SEC's charges, Kraken agreed to immediately cease offering or selling securities through crypto asset staking services or staking programs and pay $30 million in disgorgement, prejudgment interest and civil penalties.

These settlements show that the SEC and similar regulatory agencies are targeting staking and earned-interest products offered by numerous cryptocurrency exchanges. While there are currently no formal rules governing crypto lending, cryptocurrency exchanges must examine securities regulations and evaluate whether their products require registration. This is particularly true with respect to interest bearing products which appear to be under intense regulatory scrutiny.

The SEC puts celebrities on notice regarding crypto endorsements

On February 17, 2023, the SEC announced charges against former NBA player Paul Pierce for touting the EMAX token, a crypto asset security offered and sold by EthereumMax, on social media without disclosing the payment he received for the promotion and for making false and misleading promotional statements about EthereumMax products. Mr. Pierce agreed to settle the charges and pay $1.409 million in penalties, disgorgement and interest to the SEC.

This case is a reminder to spokespeople: Federal securities laws require that anyone who promotes a crypto asset security must disclose the nature, source and amount of compensation received in exchange for the promotion. Spokespeople should consult with counsel to confirm that any endorsements in the crypto asset space are in compliance with SEC regulations. This is particularly important given that crypto asset creators and the SEC frequently disagree as to whether a given crypto asset qualifies as a security.