Consumer Finance Monitor (Season 8, Episode 6): Regulating Bank Reputation Risk

Speakers: Alan Kaplinsky and Julie A. Hill

Alan Kaplinsky:
Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr law firm, and I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'll be moderating today's program. For those of you who want even more information, including a lot of information about the topic that we're going to be covering today, don't forget our blog, which also goes by the name of Consumer Finance Monitor. We've hosted the blog since July of 2011 when the CFPB became operational, so there is a ton of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry.
If you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or wherever you obtain your podcasts. Also, let us know if you have any ideas for any other topic that we ought to cover or any speaker that we should consider inviting to our podcast show. So let me give you a little bit of background before I introduce our special guest today. So, many years ago, when I say many years ago, I'm talking probably 15 or so years ago, I used to do a lot of work for companies that did payday lending and also banks who often partnered with non-bank payday lenders to offer payday lending in states whose usury laws were too restrictive and where payday lending could not be offered to consumers economically. And there were a lot of these bank partnerships with non-banks that existed until all of a sudden the bank regulators and the Department of Justice, this is during the period of time when President Obama was our president, they decided they didn't like payday lending.
The interest rates were too high. It was unseemly and it was a business that banks ought not to be involved in. And shortly after that, it actually became a crusade of sorts. The Department of Justice, I think with a lot of backing from the federal regulators commenced or launched something called Operation Choke Point, where the goal of that was to cut off banking services or funding for companies, non-banks that were engaged in payday lending. At the same time, the OCC, the Federal Reserve Board, the FDIC, the Federal Prudential Banking Regulators were telling their regulated entities that were partnering with payday lenders, that they wanted them out of that business, that they wanted them to sever their relationship with these non-bank payday lenders. They never really used the term reputation risk, although it'll come out once in a while.
They'd find other things in their examination to nitpick over, not major things, really small things. But they did talk about reputation risk that did come up, that was never really used as a reason. They just said, "You've got to sever your relationship." And when a banking regulator tells a regulated entity to do that, they do it. It was a different time period than today. Today, if a banking regulator says, "We don't like you to do something," and the bank says they don't agree, they will often sue the regulator. That's very, very common today. 15 years ago, it was very uncommon for anybody to bring a lawsuit against a regulator. Today it seems like almost anything, particularly a bank regulator comes out with a regulation the industry doesn't like, a lawsuit gets filed. It happens all the time. So anyway, that brings me to, let's call it Trump 1.0, the first term of Donald Trump.
During that term, there was an acting comptroller by the name of Brian Brooks who I actually knew very well because I used to chair a PLI program, an annual institute on consumer financial services law. And I often have Brian as a speaker on our program because he was a brilliant lawyer and very familiar with consumer finance. But at the tail end of Trump's term in office, after he lost the election to Biden, Brian Brooks, who was then the Acting Comptroller of the Currency, finalized a rule requiring large banks to provide fair access to bank services, capital and credit. It was first proposed in November of 2020. They gave a very short, I think 45 day comment period. And on January 14th, on the very same day that Brian Brooks resigned as Acting Comptroller because he knew the inauguration was coming up and Biden would appoint his own Acting Comptroller, they finalized the rule.
And it was very controversial. The proposed rule generated more than 35,000 comment letters on something that I would've thought was somewhat of an arcane issue. But there were opinions on both sides of the issue. And basically what the OCC

said, "This is not a big deal, we're just codifying more than a decade of OCC guidance, going back to 2014, stating that banks should conduct a risk assessment of individual customers." They actually refer to it as a quantifiable risk assessment of individual customers rather than to make broad-based decisions affecting whole categories or classes of customers when provisioning access to services capital and credit. Well, what happened to that final regulation? It never got finalized. It did get finalized, but then it got sent over to the Federal Register. And on January 28, literally eight days after there was a new Acting Comptroller, the agency decided to put it on hold that it had paused publication of the rule in the Federal Register, which was going to affect banks that had over a hundred billion dollars in assets.

So that never went through, but pay attention to that because it's very conceivable that the new administration and the new acting comptroller may dust off that regulation. It's already done. It just needs to be published in the Federal Register. And so we did a podcast show on May 23rd of last year with two guests, Professor Dru Stevenson of South Texas College of Law in Houston, Brian Knight, a senior research fellow of Mercatus Center at George Mason University. And we talked about Operation Choke Point, and we then devoted the remainder of our episode to discussion of what is the appropriate role of bank regulators with regard to bank customer relationships. And our guests on that show had diametrically opposite views on that subject. Then on October 31 of this year, we did a podcast entitled State Fair Access and De-banking Laws Bring Country's Political and Cultural Divisions to the Fore.

And on that podcast show I brought back Brian Knight and I brought on a new professor who's an expert in the area. The new professor was Peter Conti-Brown of the Wharton School of the University of Pennsylvania, and Peter Hardy who co-leads our Anti-Money Laundering Team at Ballard Spahr. And we talked about the state fair access laws, primarily Florida the first one, and then followed by Tennessee. And we had Peter Hardy talk about the anti-money laundering and Bank Secrecy Act concerns of the state laws, and that was that. So that's a very long introduction. I recognize that, and I apologize for its length, but I thought it would be a good way to set up what we're going to be talking about today. So our topic today is based on a very, very excellent tremendous law review article called Regulating Bank Reputation Risks published by Julie Andersen Hill. It appears in the Georgia Law Review volume 54, pages 523 through 603.

It is an exhaustive treatment of bank reputation risks. And let me now tell you about Julie's background. Julie Andersen Hill is the Dean and Wyoming Excellence Chair at the University of Wyoming College of Law. She is an expert in banking and commercial law. Her scholarly work focuses on the unwritten rules of banking regulation. She often examines how regulators respond to financial innovation. Before joining the University of Wyoming, Dean Hill was the Vice Dean in the Alton C. and Cecile Cunningham Craig professor of law at the University of Alabama. She also practiced law in the Washington DC office of Skadden Arps prior to going into academia. And while she was in private practice, she represented large financial institutions in government investigations. And before becoming an attorney, Dean Hill worked in small community banks. Fabulous background. Julie, we're so delighted to have you here today as our guest.

Julie A. Hill:

Well, it's great to be here. Thanks for having me. I feel very honored given some of the guests that you've had before on this topic, all scholars and thinkers that I respect.

Alan Kaplinsky:

Well, thank you. And we're really delighted that you're here with us today. So Julie, going to throw you some softballs at the beginning, right? I like to work up to the harder questions, so whatever prompted you to write this article on reputation risk?

Julie A. Hill:

Well, Alan, I think that you kicked it off nicely because Operation Choke Point that you were just talking about was really one of the catalysts for this article. There were lots of news reports that bank regulators were shutting down access to banking services for payday lenders, tax refund anticipation, loan providers and other industries. And I was curious about whether there were legal hooks for this or whether it was just happening entirely outside the law. And the other thing that was going on about this same amount of time that garnered some headlines, and it's not always, especially outside of a financial crisis, that banking regulation makes front page news. So when it does, you sort of have to take note. But the other thing that was happening right about this same time was the New York banking regulator, the New York Department of Financial Services issued a statement that basically said, look, if you're banking gun advocacy groups, you need to be worried about the reputation risk that they propose.

And I think what the industry probably rightly heard in this statement that was followed up by statements from the New York governor was, look, we're going to make life really difficult for you if you want to bank gun advocacy groups. And of course the National Rifle Association wasn't very thrilled about this public announcement. And so again, it was a question of what is the legal hook for this? And the hint was right there in the public statement from the New York regulator, it was this idea of reputation risk. And so I set about a systematic study of how it came to be that reputation risk became part of the bank regulatory lexicon, and also an investigation into how often and why and how bank regulators employ reputation risk is one of the tools in their toolbox.

Alan Kaplinsky:
Right. The New York Department of Financial Services pronouncement to state chartered institutions in New York, of course they don't regulate and supervise national banks, that ended up in litigation that we're going to talk about a little bit later. Because it's litigation that went all the way up to the Supreme Court. Am I right?

Julie A. Hill:
That's right. Hot issue.

Alan Kaplinsky:
We're going to get to that, but we got to lay the foundation first. What is precisely reputation risk?

Julie A. Hill:
Well, bank regulators define it very broadly basically to be the risk of any negative public opinion or negative publicity. They even say that negative public opinion doesn't need to arise based on something true or facts. It can arise based on untrue rumors. They say that it permeates banking that everything to do with banking might raise reputation risk concerns. And they say in determining the reputation risk, banks ought to encourage all of their stakeholders, which they then define to include bank regulators. So if we just distill it down what they're saying, they're saying, anytime we might disagree with you, that is a reputation risk that we think you ought to consider before you do anything. Or maybe in some instances they say it a bit more strongly than that. And I think that's where we get to de-banking concerns and Operation Choke Point-like concerns.

Alan Kaplinsky:
All right, so what do the regulators claim that their statutory authority is for reputation risk?

Julie A. Hill:
For a very long time by statute, bank regulators have had the authority to bring enforcement actions and to use enforcement tools when they find that a bank is engaging or about to engage in "Unsafe or unsound banking practices." If for those real banking nerds that want to go look this up, this is in 12 U.S.C. § 1818, a section that I'm sure you as a banking lawyer know by heart. But there is no long definition in the statute of unsafe or unsound banking practice. And so that term has been fleshed out over time partly by court cases, but partly by the regulators themselves. And regulators themselves tend to take the view that unsafe or unsound banking practice is a very broad term that includes any increased risk, even if we can't necessarily tie that risk to some sort of imminent occurring, likely to occur financial harm.
And so they say, well, if we don't have to actually show financial harm, all we have to do is show that somebody disagrees. And this is how we get a very broad definition of reputation risk. Now, it's not clear to me that every court everywhere would agree with this idea that unsafe or unsound banking practices so broad as to include even attenuated risks that can't be tied to financial harm. But nevertheless, that's I think a fair representation of where regulators are today. It's this unsafe or unsound banking practice statute that regulators have, I think more recently employed in building out reputation risk frameworks.

Alan Kaplinsky:
Now, let me get this right. If I went to the US Code and I looked in the various banking statutes that apply to national banks and other federally insured banks, state chartered banks, I wouldn't find the words reputation risk anywhere would I? I mean, they're not in any federal banking statute. It's something sort of made up out of whole cloth by the regulators. And while the

terms reputation risk appear and you chronicle in your article, many times that they have been used, I don't think they've ever been used in a formal regulation of the regulators, but am I mistaken there?

Julie A. Hill:
No, I think you're right. It doesn't certainly appear in any statute. The term unsafe or unsound banking practice initially I think was interpreted to mean primarily credit risk and market risk, the risk that people just wouldn't pay back their loans or market risk, the risk that interest rate fluctuations cause loss at banks. But then what happened starting I think in the 1990s was that regulators started to think about other types of risk, primarily operational risk. This is right when we were heading into the new century and everybody was concerned that the computers hadn't been programmed right, and Y2K would mean that the whole country would implode. And so suddenly banking regulators were thinking about harm to banks that could come from sources other than market or credit risk. And so they start building out risk associated with computer technology operation risk. And then from there we go really quickly to a much longer list of risks that includes reputation risk.

Alan Kaplinsky:
Yeah. So your article argues that the regulation of reputation risk, and I think I'm quoting from your article, "Unnecessary and harmful." Why is that the case?

Julie A. Hill:
I think that there are several things that play here. First of all, I'm not one of these people that's trying to argue reputation risk doesn't exist. I think it absolutely exists. It's just that often it's a derivative risk, which is just to say that it's a byproduct of some other risky behavior. So for example, if Wells Fargo were to open lots of unauthorized accounts, that would be illegal. It's against the law to open accounts for people who don't request them. I think it would also be fair to say that that poses a reputation risk, that if people find out that a bank is opening lots of unauthorized accounts that people might think negatively, they might close their account, they might refuse to do business with them. But in that case, and in cases where reputation risk arises just from some other primary risk, I think regulators have all the tools they need to deal with it.

Bank regulators didn't need reputation risk to punish Wells Fargo for opening unauthorized accounts. That's already against the law. If a bank engages in money laundering, they don't need their reputation risk statute because money laundering is already against the law. So there, I don't think reputation risk is even doing any regulatory work. It might be accurate to say that these actions pose reputation risk, but we certainly don't need it to punish the banks.

But reputation risk does arise sometimes when it's not derivative, partly because we define reputation risk so broadly. So if we think of a risk that arises from an untrue rumor, maybe the bank couldn't predict that because they didn't do anything wrong and the regulator can't punish it because it's untrue. Well, in those cases, it seems to me that regulators are going to be very poor at predicting when reputation risk is going to arise.

And banking regulation by its nature works best if it's proactive. So if I can say you're engaging in really risky lending and you should stop that, is much better than waiting until there are tons of losses. So here though, if it's arising not as part of some other activity that is already risky and already we have tools to deal with, I just don't think regulators are going to be very good at predicting when it might and might not happen. In many ways, banks are probably better able to assess whether their customers or their immediate stakeholders are likely to become upset, but if regulators do act in that instance when they really aren't going to be very good at predicting what risks will and won't arise, I worry that what's going to happen is that we're all going to think that regulators are just bringing enforcement actions based on their own perception about what is negative.

And I worry that this will make us think that regulators are not these really skilled financial professionals, but instead just political hacks that are using their regulatory tools to impose their own personal political beliefs. And this is really harmful to banking because banking really relies on trust and in particular on the trust of the regulators. Part of the reason that we haven't had bank runs since the 1930s is because we have deposit insurance and we all trust that the FDIC is doing a good job keeping banks from engaging in harmful activities. But if the public comes to view banking regulators as just a bunch of political hacks that are more concerned about their own idiosyncratic political beliefs, then financial risk, we won't have the same level of trust in banking. And so that's why I think it's both unnecessary and harmful.

Alan Kaplinsky:
Right, right. So in addition to your article, there was a significant amount of scrutiny as you pointed out, and I pointed out during my introductory remarks, around Operation Choke Point and the gun advocacy guidance that was issued by the New York Department of Financial Services. What ultimately happened with those issues? Let's start with Operation Choke Point and then we'll get to the gun advocacy issue.

Julie A. Hill:
So when Operation Choke Point, eventually it had received so much scrutiny in the press, I think the Wall Street Journal broke the story, that the House Oversight Committee decided it needed to investigate. They held some hearings, they prepared a report that was quite critical of the Department of Justice, but also implicated the FDIC. The FDIC's Office of Inspector General did their own investigation and produced their own report, which did in fact find some emails from examiners that seemed to be enforcing their own views on payday lenders separate and apart from other legal tools that they had. And so, one of the first things that happened early in the Trump's first administration was that his administration just announced that Operation Choke Point is over. And so I think that that sort of put the issue to bed at least as far as Operation Choke Point was considered.

But as you noted, it was still kind of in the back of the mind of those regulators, especially as they started to think about a switch in presidential administrations. And you already talked a little bit about Brian Brooks and the fair access rule. That didn't actually become a rule, but I think that in the waning days of the first Trump administration, there was a concern that even though it had been ended officially by the Trump Department of Justice, that something like it might be resurrected by the next administration. And there was that little bit of wrangling to try to prevent that from happening. So that's Operation Choke Point.

On the gun advocacy group guidance, the NRA sued, they said, look, that violates our First Amendment. We're allowed to advocate for guns if we want to. That's free speech. We are all entitled to that. They sued. The district court held in favor of the regulator saying, “well, governments can have speech too.”

And it got appealed all the way up to the Supreme Court. It was just a question of whether the NRA had properly pled facts that if true would amount to a violation of free speech. But the Supreme Court said that this wasn't a hard case at all. It was a unanimous decision that if in fact this had happened the way the NRA alleged it, it was a violation of... That they pled a violation of the First Amendment. So now the case is back to the fact finding stage, but I think it's very interesting that all of the members of the Supreme Court across the political spectrum said that this could potentially be a First Amendment of violation. And they, I think highlighted just how dangerous it is for the government and bank regulators in particular to get into the business of politics sort of divorced from risk. And that reputation risk is not a magic word that makes up for First Amendment violations.

Alan Kaplinsky:
Right. So with a change to FDIC policy, as you described, and the Supreme Court's decision concern over the regulation of reputation risk may have subsided. But instead there seems to be renewed worry that regulators are using reputation risk and other justifications to force banks to cut services to people, businesses, or industries that they don't like. Just before Thanksgiving, venture capital investor, Mark Andreessen appeared on Joe Rogan's popular podcast show. Not as popular as our podcast show, by the way.

Julie A. Hill:
Of course not. No, no. And we've got more substance too, right?

Alan Kaplinsky:
To talk about Operation Choke Point 2.0, he claimed that banking regulators have a campaign against their political enemies and that they're forcing financial institutions to de-bank the crypto industry and tech startups. Shortly after that, Elon Musk posted a clip from the podcast on his social media platform, X, asking the question, "Did you know that 30 tech founders were secretly de-banked?" What should we make? Julie, of these de-banking claims? Are regulators forcing banks to stop services to people, business or industries? Is there an Operation Choke Point 2.0? Or is this just the banks acting on their own

without pressure from regulators deciding that there are certain types of businesses they don't want to do business with for whatever reason?
They believe in gun control and don't like what's going on in the country, or they don't want to do business with companies like Pornhub or some of these online pornography companies or those engaged in crypto activities. What do you make of these? Is it an operation 2.0, Operation Choke Point? Are there banks that are really by category saying, we will not do business with this type of company, period, what's going on?

Julie A. Hill:
I think that's a really hard question to answer. I appreciate you starting with the softballs before getting to this much harder one. So if we go back to the first Operation Choke Point and think about what happened there, there were some public reports. They kind of grabbed some headlines. Regulators said, "We didn't do it, we didn't do it." Nobody really had enough information to make any definitive statements about whether it was happening or not. Businesses could say, well, we were shut off, and they didn't know exactly why and they had some suspicions, but it really wasn't until Congress decided that they were going to do an investigation and there were some document requests that there was any evidence of it. And it highlights, I think the trouble with sorting out these claims. Because as you note, banks can decide not to do business with all sorts of different customers.
They can decide they don't want to do business with a customer because they're too risky. They might decide they can't do business with a customer because they can't make money on that customer. Maybe the due diligence is just too high, or maybe they just don't like the business. Maybe they're hard to deal with. Maybe they call them all the time and make complaints, or maybe they just don't like their business. Maybe they don't have any expertise in that. We wouldn't expect a bank that specializes in agricultural lending to suddenly want to bank a bunch of crypto companies probably. So on the one hand, if you're a customer and a bank just decides not to do business with you, you have no idea why that was. They don't tell you most of the time. So they don't tell you if it was because they thought you were too risky or because they don't like you, or because their regulator told them they can't because it's against the law or because their regulator told them they can't because the regulator decided that they were reputationally risky.
And efforts to figure out what's going on behind this is all hampered by the law itself. So banking law says that all of the information surrounding bank examinations is confidential supervisory information, and neither the bank nor the regulator is supposed to release it. So even if a regulator goes to a bank and says, "You must close Melania Trump's account because we don't like the Trumps," the bank is then not supposed to go to Melania or anyone else and tell her, "Well, this is because they don't like you." So we don't know if it's because the bank doesn't like them, because the regulator doesn't like them or because the regulator thinks they're too risky. Another part of this is the anti-money laundering laws. If a bank closes an account because they are worried about money laundering or anti-terrorism concerns, a bank's prohibited from tipping off the customer that this is the reason why.
And so a bank might even purposely try to keep that secret. And so what you've got is these banking customers saying, "We lost our accounts. We don't know if we did anything wrong. Nobody told us, but we don't think we did." Certainly it's not in their interest to say, we got our account closed, and it might've been because we're money launderers, but we don't think so. And so you have these bank customers, former bank customers saying, "We got our accounts closed, we don't know why and it's not fair, but we worry that it's because the regulator doesn't like us." And what's the mechanism for finding out that it was the regulator behind it? It's very hard to do. And so you see a bunch of articles that say, this is happening, and here are all these tech founders who say it happened to them. And then on the other hand, you see people saying, oh, "It's a conspiracy theory. It's Elon Musk conspiracy," and they're overplaying and exaggerating. And probably all these customers are just really risky.
So how do we get to the bottom of whether regulators are acting in a way that relies on reputation risk or relies on other regulatory tools that really aren't framed in what we would think of as traditional financial risk? Well, Coinbase is starting to work on that a little bit. They became concerned that a bunch of banks were being told to pause or not engage with crypto related ventures or activities. And so they made a Freedom of Information request to the FDIC, which the FDIC promptly declined saying all this is confidential. Coinbase decided to litigate it. And so over the last couple of months, we've seen a couple releases of some of these letters. First, the FDIC tries to say, "Well, these are trade secrets of these banks, and they wouldn't want to get it out." But when some of the letters come out, then you see the banks behind them saying, "Yeah, that

one's ours." And some of these letters are something that makes you wonder what's behind it, because some of them will say, "We're not sure what you were supposed to file, but we're asking you to pause."
What's the legal hook there? And I think it raises another question that kind of around crypto, which is, okay, so this is new, and I understand regulators need some amount of time to get up to speed, but at what point do we think that it would be fair for regulators to have a transparent rule that banks and their customers could follow? Or transparent guidance versus these hidden letters to supervisors that they claim would destabilize the whole industry if we ever possibly heard about them? So I think that part of the trouble behind all of these is that it's just a complete lack of transparency. So whether it's happening or not, you're going to always have some people who think it's happening because there's no way to prove that it's not from the outside. And regulators are incentivized to say it's not us. And they said it wasn't us in Operation Choke Point 1.0, and we found out that wasn't exactly true.

Alan Kaplinsky:
Right. So let's fast-forward now, and it appears that the new Trump administration and some members of Congress are troubled by de-banking claims. What sort of policy changes are likely to be considered?

Julie A. Hill:
One that's likely to be considered is just either an administrative rule or an actual bill in Congress that says that regulators can't use reputation risk by itself, that the reputation risk isn't a basis for an enforcement action. This would give it a little bit more teeth than it has now when regulators just put it in their own guidance. And it might also make it so that a bank that felt that they'd been wronged by that or a customer that felt that they'd been wronged by that would have a better legal hook to sue if they found out. So that's I think kind of a rule or law that you think about if you think that the government really is overreaching on some of these de-banking claims.
Now, if you think though that de-banking is driven not by the government, but by banks just deciding that they don't want to do business, and your view is that basically everyone who's operating within the law ought to be able to get a bank account at any large bank, then we might see some legislation that requires banks. Typically, it wouldn't be all banks because we want to preserve the small ag lender or whatever, but the really large banks would have a duty to provide banking services to legally operating businesses and individuals.

Alan Kaplinsky:
You say legislation, but wouldn't it be easier to have whoever the new Acting Comptroller is just dust off Brian Brooks's regulation that maybe because of the length of that's elapsed, they'd have to go through another notice and common period under the APA. But wouldn't that be an easier thing to do? Although I recognize that today as opposed to four years ago, the Chevron opinion used to be viable four years ago. It's been overruled by the Supreme Court and you now have Loper Bright Enterprises, so not as much deference. In fact, no deference is supposed to be given to a regulation of a state agency. It's just looked at just another opinion like anybody, and that the courts have to make their own reach your own conclusion. But what do you think, do you see this going on legislatively or do you think they'll let the OCC deal with it and then maybe the FDIC and maybe the Fed?

Julie A. Hill:
Yeah, so I think you're probably right that some sort of even joint rulemaking is perhaps the most expeditious way to make it happen if it's really driven by the administration. But you noted some reasons why regulation might not be the preferred fix of everyone. One is that we think going forward courts are less likely to be deferential to agency rulemaking than they might have been in the past. The other is I think that people generally think it's easier to change a regulation than it is to change a statute. And so if what you're looking for is a permanent fix, sometimes political parties want to make that permanent fix when they think they've got the votes to do it, and then worry about their opponent or the people who disagree with them trying to undo it later. And so that's another reason I think that some members of Congress will probably look at legislation for this because it is generally thought legislation is more sticky than regulation.

Alan Kaplinsky:
Yeah. What about other things, I've heard in your article, you said something about disclosure rules, what did you have in mind there?

Julie A. Hill:
Well, so one parallel that we might think of is in the fair lending context, I know you've done probably some fair lending stuff too. But as Congress and regulators were started to be concerned about redlining or about banks denying loans for discriminatory reasons, one of the things that hampered potential plaintiffs was that they didn't know why they had been denied loans. And so part of the legislative attempt to fix that were some disclosure requirements that said things like if you deny a loan, if you deny a mortgage because the property appraised for too low, bank, you have to tell the customer that that's why you denied the loan. And if you are going to deny a loan, you need to deny it. You need to not just sit on the application for years and years, and then when they threaten to sue, you grant the loan application.

And so we might be able to take some information from that context and say, look, if you are going to close an account for a reason based on risk, and we'd probably have to accept at least some anti-money laundering laws, if you're going to close an account based on risk, you should tell the customer why it is you're closing the account. If you're closing the account because it's not profitable, tell them that. If you're closing it because of risk, tell them that. If you're closing it based on regulator requirement, you should tell them that. This would do a couple of things. One is it would potentially make banks think twice before they close the account because you got to have a reason for doing it.

But it would also potentially create a class of plaintiffs or a class of people who know why their account was closed, or at least know the reason that banks claim that the account was closed. And let the potential plaintiff gather information about why that is. And so if we get bunches of letters that say, "We're closing your account over reputation risk," well, that'd be pretty good evidence that they're using reputation risk in this manner. And so I think it's possible that some disclosure laws could kind of move us away from rumors about de-banking and what's causing it, which might be a good thing.

Alan Kaplinsky:
Yeah. Let me just add a footnote to what you said. If we're talking about a credit application covered by the Equal Credit Opportunity Act, there already is a requirement that if you reject a loan... Well, actually it's the Fair Credit Reporting Act as opposed to Equal Credit Opportunity Act. The Fair Credit Reporting Act requires a bank or a non-bank who is rejecting an application covered by that statute to give its notice of adverse action and to give a reason for it. Now, it covers only certain kinds of transactions with banks, not all transactions. So I guess what you're saying is you would broaden the scope of something like the Fair Credit Reporting Act to cover all kinds of transactions with banks, not just credit transactions.

Julie A. Hill:
Yeah, I think that disclosure, and I think they'd have to be a little different than the ones that are in the Fair Credit Reporting Act, but I think that some amounts of disclosure surrounding both account closures and denials of requests to open accounts might provide greater transparency in this area.

Alan Kaplinsky:
Right, right, right. Okay. So also, I read in your article about regulatory transparency regarding new financial products. Could you describe what you meant there?

Julie A. Hill:
Yeah, so I think that the trouble with new financial products is really that they're new and the law doesn't progress at the same speed that technology does. And so what usually happens is we come up with a new financial product and then we figure out after that financial product how to regulate it. And regulators are still, I think, a little bit traumatized by the 2008 financial crisis. We have mortgage-backed securities and everybody engages in them, and then later we decide maybe we didn't do the world's best job regulating that risk in these new types of products. But this can happen in financial products with new technology, but it can't be either that we just take new products and shove them into the old law because that doesn't work. And it also can't be that we just don't have any new financial products or new technology because we can't get around to changing the law or figuring out a good regulatory framework for these things.

And so what I think a thoughtful regulator ought to try to do is balance those two things. So I am not saying that anytime a new product comes out, we just have to let everybody try it until we have a big financial crisis. But what regulators should be doing is doing their very best to get up to speed and develop reasonable frameworks for the new technology. And they ought to be thinking about frameworks that keep new technology within guardrails, but also allow people to experiment with it to innovate, because we don't want to be the financial system without innovation. It can't be that we don't ever come up with new law, and so we just don't regulate new stuff. But it also can't be that we're so secretive and we say nothing about how to regulate these new things and we just shut them down before they're even out of the gate.

Alan Kaplinsky:
Right. Let me ask you one final question. This may sound odd to you, but you've heard of the concept of conscientious objection, right? That it was used as a way of avoiding being drafted years ago when there was a draft into the military service if you could claim that you were a conscientious objector. Do you think there's such thing as a bank being able to conscientiously object to certain kinds of businesses such as energy businesses, those that are involved with fossil fuel, those that are doing business with online pornography? What's wrong with that? That shouldn't apply in the corporate context. That's only something that an individual, a right, that an individual has to conscientiously object.

Julie A. Hill:
Look, we've got what, nearly 5,000 banks and about that many credit unions. I think from a national perspective that it doesn't do us any financial harm to let banks make decisions about their own personal views, about the reputation risk or the morals or conscientiously object from serving certain industries. So if my local credit union or bank doesn't want to serve Pornhub, it doesn't bother me greatly because I think in a robust banking market, you're likely to find someone who will. Now, my views on that might change a little bit if we see significant consolidation in the banking industry. If we get to a point where there are only a handful of... And this is the case in some countries, so I don't think that it's that far-fetched.

Alan Kaplinsky:
Canada doesn't have that many banks.

Julie A. Hill:
If we had a situation where only a handful of firms controlled all of the banking services in the country, I think I would feel much more heartburn about letting them make moral decisions about who can be banked and who can't. But in a banking market that is diverse and has lots of participants, I don't have as much concern about individual banks making decisions because I think individual banks are a lot like individual people that they'll have different values and that those will sort of shake out. But I think it depends on the nature of the banking industry.

Alan Kaplinsky:
I mean, some people want me to be the devil's advocate, and I don't agree with this at all, but some people think that banks are like a public utility. Because of the very close relationship that they have with the federal government, namely that the FDIC insures most of their deposit accounts, so that if there is a failure by the bank, government has to pony up the money to make people whole. Do you think banks are a public utility?

Julie A. Hill:
So there are some academics who think that, Mehrsa Baradaran and Saule Omarova, I think we could definitely put them in that category, that banks have a social contract because of the government benefit they receive from insurance or regulation or whatever else, bank bailouts. I just don't think that. Banks are still largely fueled by private capital. And if we want banks to continue to be fueled by private capital, they can't be treated as government entities. That's just not going to work. But see if you disagree with Professor Hill, there are certainly some professors out there that you probably enjoy their work.

Alan Kaplinsky:
All right, well, we've covered a lot of territory today. And first I really appreciate, Julie, the fact that you took the time out to come on our program today. I think you shed a lot of light on this sort murky area of bank regulation. And it's going to be

very interesting to see how this play out during Trump 2.0. Maybe you'll have to come back in about a year because I have a feeling this is going to be a priority issue for the next administration. It's not something that they've talked a lot about, but I do think this is an issue when people ask me what kinds of regulations do I think the CFPB or the banking regulators are going to come out with, the first thing I think about is something dealing with fairer access. So we'll see if I'm right. So again, thank you, Julie, for being on the show.

Julie A. Hill:
Well, thanks for having me. It's a pleasure to be here. There are not enough people in the world who want to talk about banking with me, so I always appreciate the opportunity. And especially people who will read my article and say nice things about it, I appreciate that.

Alan Kaplinsky:
Well, thank you. We ought to start an advocacy group called Banking Nerds of America or something like that.

Julie A. Hill:
Indeed. Indeed.

Alan Kaplinsky:
So to make sure that you our listeners, don't miss any of our future episodes. Subscribe to our show on your favorite podcast platform, Apple Podcast, YouTube, Spotify, or wherever you listen. And don't forget to check out our blog, consumerfinancemonitor.com for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast, that's singular, @ballardspahr.com. Stay tuned each Thursday for a new episode of our show. Thank you for listening, and have a good day.