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Dust-up at FDIC portends bigger fight over bank regulation

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A power struggle on the Federal Deposit Insurance Corp.'s board of directors could radically alter bank regulatory policy during the Biden administration, observers said.

Two directors — Consumer Financial Protection Bureau Director Rohit Chopra and former FDIC Chair Martin Gruenberg — sent shock waves through the capital when they announced the board's Democratic majority had launched a review of bank merger policy without the support of Trump-appointed FDIC Chair Jelena McWilliams.

Progressives saw the move as a necessary step to undo Trump-era deregulation while Republicans have accused Chopra and Gruenberg of trying to execute a coup at the agency. Others fear the fight may devolve into a legal quagmire that could bring joint policymaking among the federal bank regulators to a standstill.

"This is the kind of thing that would probably end up in court and take years to figure out," said Norbert Michel, vice president and director at the Cato Institute’s Center for Monetary and Financial Alternatives. "Nobody's going to win in that regard."

Yet others note that policy progress had stalled at the FDIC since the President Biden's election resulted in a 3-1 Democratic majority on the board, with McWilliams as the lone Republican despite running the agency. The impasse has frustrated Democrats, who have seen the board dynamic standing in the way of their policy aims.

Executing some kind of power play at the FDIC — with Democratic board members weighing their options while holding the majority — has quietly been under consideration since the Biden administration came to power.

Never have FDIC board members acted without the approval of the agency’s chair — a point made by McWilliams’s office at the FDIC on Thursday. She has staunchly rejected the board's vote requesting public comment on the bank merger approval process, calling it illegitimate.

Progressives say such a move was long overdue and justified by the board’s solid 3-1 Democratic majority. The board’s third Democratic appointee, acting comptroller of the currency Michael Hsu, also voted in favor of issuing the request for information. (The board's fifth seat is vacant.)

“This is going to be a bruising fight between Chairman McWilliams and the three progressive directors,” said Todd Phillips, director of financial regulation and corporate governance at the Center for American Progress and a former FDIC attorney. “But it's one that I thin the three progressive directors are going to win. They have the numbers, and they have the law on their side.”

Others say Chopra and Gruenberg crossed a line, undermining McWilliams's authority.

“I don't recall anything like this,” Michel said. “It's pretty damn brazen. I would argue that people should be disturbed by this.”

But many in Washington have argued it was McWilliams' decision to rebuke the vote of a majority of her board that went too far.

"Directors Chopra, Gruenberg, and Hsu have done their duty as civil servants and obeyed the letter and spirit behind the FDIC’s design to a T. For Republicans to call their actions a 'coup’ just shows how authoritarian Trump’s party has become, and all for the sake of letting big Wall Street banks gobble up their competition uninhibited," Jeff Hauser, executive director of the Revolving Door Project, said in a statement.

"Trump’s final holdovers in office should not be allowed to enact the Trumpian agenda of overruling majority rule. McWilliams is wildly out of line, and should be condemned and disregarded," Hauser said.

The next battle could be over whether the request for information on bank mergers gets published in the Federal Register. That would kick off a comment period and solidify the legal basis for the three board members' vote. Democrats have long wanted changes to a merger approval process that they see as too lax for acquirers.

The stakes for future polices are substantial. The conventional wisdom in Washington has held for decades that the chair of the FDIC wields significant if not unilateral power over the matters that the agency’s board of directors considers. With McWilliams’s term not set to expire until 2023, left-leaning advocates had assumed ambitious interagency policymaking would be off the table until then.

But if it is successful, Chopra, Gruenberg and Hsu’s runaround could significantly expand what Democrats can seek to accomplish.

“It means they're going to be able to get out things, like climate guidance and climate regulations, that McWilliams seems like she has been stalling,” Phillips said. “It also means that the three banking agencies" — the FDIC, Office of the Comptroller of the Currency and Federal Reserve Board — "are going to be able to roll back some of the prudential regulations that were put in place during the Trump administration.”

But the gambit also carries significant risks, analysts say, and the relationship between the nation’s bank regulators may never be the same.

"This was an unnecessary, unforced error by" the Democratic board members, said Richard Hunt, president and CEO of the Consumer Bankers Association. "It makes this whole process dirty in Washington, D.C., when we're supposed to be the envy of the world when it comes to our banking system and as regulators."

Meanwhile, the episode shines a brighter spotlight on Chopra's unusually pivotal role in trying to influence FDIC policy.

Senior officials at the FDIC told reporters on a background call Thursday night that Chopra communicated to McWilliams in late October his desire to issue a request for information on bank mergers.

FDIC officials also claimed that McWilliams had directed her agency's staff to develop the request for information through its typical channels. The staff's draft version was being circulated when Chopra and Gruenberg announced their own version of the request — which was not worked on by any FDIC staff, the agency officials said.

An eight-page internal memo prepared by the staff of CFPB, which was obtained by American Banker on Friday, argued the legal authority of the FDIC rests with its board of directors — not its chair — and outlined a written-vote process that does not require the chair's approval.

The CFPB's legal memo cites the Federal Deposit Insurance Act of 1950 that states that "the management of the Corporation shall be vested in a Board of Directors." The memo also cites FDIC bylaws stipulating that "the Board of Directors may transact business by the circulation of written items."

The written voting bylaws provision "does not mention the Chairperson or indicate that Chairperson presides over written voting," the memo states. "The executive and administrative authority invested in a corporate Chairperson and CEO unequivocally does not include controlling the voting of a corporation's board."

The CFPB legal memo also delves into the authority of the FDIC chair, arguing that courts "have unequivocally indicated that a board's chairperson cannot prevent a board from making decisions."

But an FDIC spokesperson said the agency "does not agree with the conclusions in the CFPB's legal memo, and does not plan to debate such disagreements through the media."

The memo cites Supreme Court precedent that "a majority of the quorum of a multi-member agency is authorized to act on behalf of the agency."

"Chair McWilliams' argument is that she gets to set the agenda for FDIC board meetings and because she didn't put the item on the agenda, it cannot be voted on," Adam Levitin, a law professor at Georgetown Law School, wrote in a blog post Friday. "If that's the argument, it is plainly wrong."

FDIC bylaws allow for votes taken on paper without a formal meeting, known as "notational votes," Levitin said.

"The notational vote move sure seems to leave Chair McWilliams without a legal argument," he wrote. "If Chair McWilliams has some real basis for legal argumentation, she needs to present that case to the public. Otherwise, she's acting in bad faith here."

Jeremy Kress, a law professor at the University of Michigan, agreed that under the Federal Deposit Insurance Act, McWilliams "has the authority of chief executive officer of the corporation."

"I'm a professor of business law, and I can tell you that I am aware of no precedent that says that the CEO of a corporation can overrule a majority of the board of directors," Kress said.

But others say the CFPB's involvement in the affairs of the FDIC should raise alarm bells for policymakers everywhere.

"You can read the statutes any way you want, but it's pretty obvious that the CFPB director and the comptroller are not put on the FDIC board so that they can take the agenda of the FDIC over if they don't like what the chairman is doing," said Michel. "That's just ridiculous on the surface."

Just how this conflict will be resolved remains to be seen. Policy analysts say that litigation is highly likely, and that the FDIC chair may seek to drag out the fight with Democrats as long as possible in order to block their agenda until her term ends in 2023.

Others said the fracas will make it tough, if not impossible, for Democrats on the board to work with McWilliams.

"We suspect this will further sour relations among board members, especially between McWilliams and CFPB Director Rohit Chopra," said Jaret Seiberg, managing director at Cowen Group. "That suggests it will be difficult to get anything done. Even if the proposal is published, there will likely be litigation on [whether] it is valid."

Other analysts say that because the specific action being disputed — a request for information on bank merger policy — has a limited immediate policy impact, a judge may hesitate to resolve questions of statutory authority.

"This is kind of a weird vehicle to litigate [given] this is just a request for information," said Kress. "It has practically no legal effect. It's not even a proposed rule. So if the parties were to try to litigate on this specific issue, it's possible that a court might say this is non- justiciable."

But it also remains unlikely that the action taken Thursday by Chopra, Gruenberg and Hsu will be the last time Democrats on the board attempt to advance policy on their own.

"I think we all know that this is really a proxy fight over the entire FDIC agenda for the next 18 months," Kress said.