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RECOUP Act / FEND Off Fentanyl Act Outlook

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<p>OVERVIEW</p>	<p>On June 21st, the Senate Banking Committee held its first markup since 2019 to advance two pieces of legislation. The first piece, championed by Ranking Member and Republican presidential hopeful Tim Scott (R-SC) in coordination with Chair Sherrod Brown (D-OH) was the FEND Off Fentanyl Act (S. 1271). This bill is intended to heighten the use of sanctions and anti-money laundering tools to punish Chinese precursor manufacturers and Mexican cartels trafficking fentanyl into the US. This legislation passed the committee with unanimous support. The second, and more controversial measure is the Recovering Executive Compensation Obtained from Unaccountable Practices (RECOUP) Act, also led by Chair Brown and supported by Ranking Member Scott. This package came together following the Silicon Valley Bank (SVB) failure and aims to increase accountability of bank leadership by focusing on their compensation as it relates to regulatory compliance, corporate governance, and bank performance. While the legislation garnered a surprising amount of bipartisan support, as it passed out of the committee on a 21-2 vote, there will be significantly more criticism to come as this legislation works its way to the Senate floor and ultimately the House for consideration. It is expected that Majority Leader Schumer (D-NY) will work to bring these two bills to the Senate floor, potentially before the August recess, presenting a significant opportunity for various financial services priorities. We expect there will be significant lobbying by Senators for consideration of their priorities, changes to the executive compensation provisions, as well as significant asks from House Republicans in order for them to accept a package currently opposed by the House Financial Services Committee (HFSC) Republicans. While a broad swath of stakeholders will attempt to modify this package, the chance of success varies by the issue, and we will attempt to provide a forecast of what to watch as this negotiation unfolds.</p>
<p>OUR VIEW</p>	<p>Our view is that there are few significant amendments that could realistically be added to the RECOUP Act or the FEND Off Fentanyl Act on the Senate floor, but that there will have to be changes made in order to pass some form of this executive comp clawback legislation. This will likely mean tweaks to the executive comp provisions, and ultimately negotiations with HFSC Chair McHenry (R-NC) and HFSC Republicans to move this across the finish line. If this legislation does make it to the Senate floor this month, we anticipate significant pushback by progressives (who want to make it stronger) and some conservatives, controversial amendments on ancillary financial policy items, and attempts to make major substantive changes by some dissenters. In the end, we believe that the bill is likely to slip past the August recess, but that it will come to the Senate floor in the fall.</p>
<p>RECOUP ACT HIGHLIGHTS</p>	<ul style="list-style-type: none"> • Provides increased authority to the banking agencies to allow them to remove and prohibit senior executives from the banking industry who “demonstrate misconduct in their oversight of a bank” and “fail to appropriately implement risk, financial, or other controls.” • Requires all banks with \$10 billion in assets or more to include new heightened governance and accountability standards in their bylaws. • Grants the FDIC the authority to clawback compensation awarded to senior executives in the 24 months prior to a bank’s failure. This includes incentive, equity, and

	<p>performance-based compensation, along with any profits from the sale of the bank's stock.</p> <ul style="list-style-type: none"> • Increases civil money penalties imposed on senior executives from \$1 million to \$3 million. • Requires agencies to consider an acquiring bank's position as it relates to federal and state deposit caps alongside consideration of the least-cost resolution requirements. There is concern that this could create a scenario where small bidders receive priority in bidding for failed banks. • Amendments were included in the markup version that require increased transparency from the banking regulators and institute a review process of the regulators' supervision prior to any bank failure to understand if supervisory mistakes occurred at the regulator level.
POSSIBLE RECOUP ACT CHANGES	<p>We do anticipate continued negotiations over the individual provisions of the underlying executive compensation legislation. This will involve some Democrats looking to strengthen the authorities in the proposed bill while Republicans attempt to place guardrails on some of the bill's key provisions. The below are areas where members could state their case as negotiations unfold.</p> <ul style="list-style-type: none"> • Changes to the length of the lookback period that sits at 24 months in the SBC passed version of the bill. Progressives would like to see this period extended, while Sen. Tillis (R-NC) and Sen. Hagerty (R-TN) would like to see it reduced. • Republican's currently in opposition of the bill would also like to see the application of these increased regulatory authorities limited in application only to failed banks, as well as changes to the standards of conduct that trigger clawbacks. • There is support among some Democrats to expand the categories of compensation eligible for clawback beyond the current incentive, equity, and performance-based compensation. • Disagreement also remains over the provision allowing the banking agencies to remove and prohibit executives from the industry based on their conduct.
PROCESS	<ul style="list-style-type: none"> • If Leader Schumer brings this legislation to the floor as a standalone package in July or later in the year, he will need to limit amendment consideration on the floor. An open amendment process will allow Senators to force votes on unrelated financial services policy items, which may potentially expose his moderate members up for reelection to tough votes. That said, we expect the opposition to this legislation will attempt to disrupt this process where they can use procedural steps and attempt to negotiate substantive changes through a manager's amendment. • There is also the potential that this slips down the list of Senate priorities as items such as government funding become more pressing, and Senate Democratic leadership ultimately attempts to attach it to a broader year-end package. • Also key to this are HFSC Republicans. If they do not receive concessions, they could work to block the bill in the House or push to pass their own version of the package, likely prolonging the negotiation process for this legislation.
SENATE BILLS POTENTIALLY CONSIDERED FOR A RECOUP ACT PACKAGE	<p>Interchange Fees – Durbin (D-IL) / Marshall (R-KS) The Credit Card Competition Act of 2023 (S.1838), which seeks to change the credit card interchange system, continues to be championed by Sen. Durbin. This legislation would require Visa and Mastercard to accept unaffiliated payment networks for processing credit card payments, with the Fed responsible for the compliance. This legislation follows the Durbin Amendment to the Dodd-Frank Act that limited interchange fees as it relates to debit cards. This battle once again pits the large card companies and banks against the big retailers and has been a lurking issue for years.</p>

While we expect this to be one of the bills that receives significant discussion and debate behind the scenes, we do not believe that this will ultimately come up for debate or an amendment vote for the final package. This issue has both bipartisan support and opposition from key members in each party, but we do not believe Senator Schumer will be inclined to bring it into the spotlight. Additionally, many House Republicans have concerns about this standalone legislation and the addition of this legislation would only increase their opposition to this package.

Cannabis Banking – Merkley (D-OR) / Daines (R-MT)

Legislation known as the Secure and Fair Enforcement (SAFE) Banking Act (S.1323) has been a topic of discussion for years now and has seen a steady increase in bipartisan support, largely in line with broader trends related to state level marijuana legalization decisions. The bill would prohibit federal regulators from terminating or limiting either deposit or share insurance of financial institutions solely for doing business with legal cannabis companies – effectively a safe harbor for these banks. The SAFE Banking Act is designed to address the problem of cannabis companies operating in states that have legalized marijuana being unable to access financial services from banks due to the federal prohibition.

Our initial view is that it is unlikely this legislation will make it into this package. While Leader Schumer made reference to this legislation in his [Dear Colleague](#) over the weekend, detailing priorities for the July work period, it is more likely that this legislation is addressed through a Senate Banking Committee markup, but standalone floor consideration remains unlikely in July. A SAFE Banking markup would potentially setup another opportunity for a legislative trade with Ranking Member Scott who has interest in advancing a housing related bill as he continues to bolster his dealmaker resume for the campaign trail. Another factor to watch is what, if any, additional criminal justice related measures progressive Democrats look to add to this legislation that go beyond banking access and draw Republican opposition.

Strengthening Federal Reserve System Accountability Act (S. 1663) – Warren (D-MA) / Scott (R-FL)

This is legislation that was introduced in response to the SVB collapse and is intended to limit the role of bank executives on the board of directors of Federal Reserve banks. Senator Warren cites the role of SVB’s CEO as a member of the Federal Reserve Bank of San Francisco’s board of directors at the time of the bank’s failure as a conflict of interest. Among other measures, this legislation would prohibit bank executives from banks with greater than \$50 billion of assets under management from sitting on these boards and would require 6 of the 9 independent board members to be appointed by the Fed Board of Governors in Washington, as opposed to the 3 positions they control today.

Given that another banking agency oversight legislation was added to the RECOUP Act in the final negotiations before the markup, it is likely that this bill has already been ruled out. That said, given its relevance to the SVB failure specifically, we expect that this bill could remain in the conversation as negotiations progress.

Federal Reserve Inspector General (IG) Bill (S. 915) – Scott (R-FL) / Warren (D-MA)

This is another piece of legislation from Sen. Scott and Sen Warren that was introduced in the SVB aftermath. This bill looks to utilize the Senate’s nomination review authority to increase the accountability of the Federal Reserve and the CFPB through the creation of a presidentially-appointed and Senate-confirmed IG. If passed, this would diminish the independence of the Fed and bring it in line with other federal agencies in terms of independent IG supervision.

Similar to the opinion above regarding S.1663, the RECOUP Act already included another provision regarding transparency of the banking regulators. While this proposed step to increase supervision of the Fed has garnered a bipartisan group of cosponsors, the odds for inclusion are not believed to be high at this point. This could change if there are any major revelations

	<p>regarding Fed supervisory lapses, as it relates to the recent bank failures before this legislation is finalized.</p> <p>Prohibiting IRS Financial Surveillance Act (S. 453) – Scott (R-SC) S. 453 responds to a provision in the Build Back Better plan that called for banks and other financial institutions to increase customer information sharing with the IRS. This provision includes transactions exceeding \$600 on mobile money apps like Venmo, PayPal, Cash App, etc.</p> <p>This would be a purely partisan ask by Ranking Member Scott, given this legislation currently has no Democratic cosponsors. While there may be a trade here, we view this as highly unlikely, especially considering the politicization of IRS funding and oversight we have seen following the injection of funding included in President Biden’s Inflation Reduction Act package.</p> <p>Fair Access to Banking Act (S. 293) – Cramer (R-ND) This legislation would punish banks if they refuse to provide financial services to “constitutionally-protected industries and law-abiding citizens.” The primary industries this aims to protect are oil and gas and firearms. This was a Republican response to banks backing away from banking these industries or setting target dates for lowering their exposure to certain industries, often portrayed as a reputational risk mitigation strategy.</p> <p>Similar to Ranking Member Scott’s bill, we view this as another partisan ask that is unlikely to make it into the final package. That said, there are certainly members of the HFSC who would be supportive of this addition, particularly in their ESG hearing series. We do not see Chair Brown agreeing to a trade that involves this legislation though.</p>
<p>HOUSE FINANCIAL SERVICES COMMITTEE CONSIDERATIONS</p>	<p>House Outlook As mentioned in our introduction, there are significant hurdles for this legislation to clear prior to making it out of the Senate. Depending on Leader Schumer’s approach, he could attempt to address House Republicans’ concerns prior to passing it out of the Senate for procedural reasons. No matter what, Chair McHenry and other committee members will likely seek changes to the executive compensation provisions, as well as some legislative priorities of their own, in exchange for their support. It is worth considering the political optics here. Punishing bank executives will likely win some support from the more populist Republican faction, and if leadership views this as a moving vehicle they cannot stop, the question quickly becomes, “what else can we get in exchange?” Some of the potential asks include:</p> <p>Stablecoin and Digital Asset Market Structure Bills – McHenry (R-NC) Chair McHenry and his staff have been working through draft versions of digital asset bills as they have moved through related hearings in May and June. We anticipate a markup in mid-July, which would likely produce the negotiating point for two key measures that Chair McHenry would like addressed in any upcoming financial services legislative package. While Chair Brown would likely prefer to keep the digital asset bills separate from the executive compensation and fentanyl issues, we see these as two big ticket items that the HFSC could push for in order to accept the RECOUP Act.</p> <p>Accredited Investor Bills Republicans have targeted changed to the accredited investor standard for a while now, but despite broad bipartisan support in the House (the bills below passed on suspension), Chair Brown and other Senate Democrats have opposed them due to push back from progressive groups. These are viewed as a likely ask from House Republicans if they are going to accept the clawback proposal.</p> <ul style="list-style-type: none"> • Fair Investment Opportunities for Professional Experts Act (H.R. 835) – Rep. Hill (R-AR) • Accredited Investor Definition Review Act (H.R. 1579) – Rep. Huizenga (R-MI)

- Equal Opportunity for All Investors Act (H.R. 2797) – Rep. Flood (R-NE)

Other Candidates for HFSC Republican Support

The below are House capital formation bills that we believe Republican HFSC leadership may bring up in negotiations with Chair Brown in an effort to garner Republican support of the broader package. While the Committee’s exact requests are not known prior to consideration, bipartisan support and industry familiarity make these potential targets.

- **Reg D Angel Investors** – HALOS Act (H.R. 1553) – Rep. Lawler (R-NY) / Rep. Gottheimer (D-NJ)
- **403(b)** – Retirement Fairness for Charities and Educational Institutions Act (H.R. 3063) – Rep. Lucas (R-OK) / Rep. Gottheimer (D-NJ)
- **E-delivery** – Improving Disclosures for Investors Act (H.R. 1807) – Rep. Huizenga (R-MI) / Rep. Nickel (D-NC)
- **MiFID** – Codifying SEC no-action letters excluding broker-dealers compensated for certain research services from the Investment Adviser definition (H.R. 2622) – Rep. Sessions (R-TX) / Rep. Wagner (R-MO)
- **AFFE Calculations** – Access to Small Business Investor Capitol Act (H.R. 1379) – Rep. Sherman (D-CA) / Rep. Huizenga (R-MI)

ESG Bills

As mentioned in our July preview, the HFSC Republicans have lined up a series of hearings throughout the month of July that will focus on ESG from a variety of different angles. However, it is our view that any ESG bill would be a nonstarter for Chair Brown and Senate Democratic leadership in these negotiations.