United States Senate

WASHINGTON, DC 20510

February 9

Hon. Jonathan Gould, Comptroller Office
of the Comptroller of the Currency
400 7th St. SW
Washington, DC 20219

Hon. Travis Hill, Chairman
Federal Deposit Insurance Corporation
550 17th St. NW
Washington, DC 204 9

Re: Prohibition on Use of Reputation Risk by Regulators (Docket ID OCC-2025-142; RIN 3064-AG12).

Dear Comptroller Gould and Chairman Hill:

We write to urge the Comptroller of the Currency and the Federal Deposit Insurance Corporation to withdraw their proposal prohibiting the agencies from using reputation risk. The proposal will remove a critical tool to keep the financial system protected from bank failures and from criminal activity like money laundering and fraud.

We urge the agencies to continue allowing supervisors to use reputation risk to crack down on banks when they facilitate illicit transactions, do business with criminals, sell products that harm consumers, or engage in risky practices like having a highly concentrated deposit base. If the agencies determine to place additional restrictions on use of reputational risk, those restrictions should be consistent with the more modest approach in the bipartisan AFER Banking Act (S. 860, 118th Congress) and in the FDIC's settlement in connection with "Operation Chokepoint" litigation from 19.

The proposal would prohibit the agencies from taking any action against a bank "on the basis of reputation risk." This means that reputation risk could not play even a 1% role in an agency's decision. This approach would reshape supervision and enforcement in a way that will harm taxpayers, depositors, and the financial system. It would give banks powerful tools to challenge their supervisors by arguing that regulatory actions are based on "reputation risk" and lack a "clear and direct" connection to the bank's financial condition. For this reason, supervisors will likely think twice before citing banks for deficiencies stemming from overlapping concepts like operational risk and legal risk that are similarly difficult to quantify in financial terms. As a result, routine supervisory activity will be snarled, and supervisors will be less able to raise red flags as they see them. That will allow risks to build up, which could threaten the safety and soundness of banks under your supervision.

If the agencies decide to proceed with rulemaking, a more sensible approach would be to prohibit reputation risk from being the "dispositive factor" or the "sole" basis of a supervisory decision, with exemptions for activity that is an unsafe or unsound practice, a violation of a law or guidance, or that could lead to issuance of a matter requiring attention. There should also be a broad exemption for activity that could implicate any criminal or national security concern in the discretion of law enforcement agencies like the FBI. This is the approach proposed in the bipartisan AFER Banking Act and that was already adopted by the FDIC in 19.

The banking agencies themselves have recognized that reputation risk is financial risk. In its supervision manuals, the OCC had noted that reputation risk is "the risk to current or projected financial condition and resilience arising from negative public opinion." The key

financial impacts from reputation risk are a decline in a bank's customer base, costly litigation, or revenue reductions. We note three examples.

First, the Jeffrey Epstein case. Several of the Nation's largest banks provided Mr. Epstein with access to the U.S. financial system following his criminal plea and prison sentence for soliciting child prostitution in 8. It wasn't until Epstein was arrested again in 2019 that one bank finally reported thousands of suspicious transactions. During this period, employees at these banks warned that maintaining ties with Epstein could harm business due to reputational concerns but were overruled. As a direct result of reputation risk mismanagement, several banks paid out fines and settlements totaling hundreds of millions of dollars. Under this proposal, supervisors would be prohibited from directing the banks to "discontinue doing business with [Epstein]. . . on the basis of reputation risk." They would not be able to even ask about the extent of their ties to Epstein. As a result, banks may be inclined to overlook clients showing indicia of fraud or other illegality so long as the relationship proves lucrative.

Second, the banking panic that occurred in March 2023. This crisis was triggered by runs at three banks from a highly concentrated customer base. Depositors lost confidence in these banks and pulled their money, causing them to collapse. ubstantially all the deposits of one failed bank—and therefore its funding—was derived from customers in a single industry. Among those customers were FTX which used this bank to steal customer funds and siphon them to an affiliated hedge fund called Alameda. In a post-mortem report, the FDIC drew a link between reputation risk and the bank's failure by noting that "[b]y the time of FTX's failure, [this bank] was well known as a bank that provided deposit services to crypto businesses. Bank executives had sought to cater to digital asset companies … Thus, there was increased scrutiny on [this bank] with each successive failure and collapse in the crypto space."

This bank also handled funds of the Binance digital asset exchange that were allegedly used in a securities fraud scheme. Under the proposal, supervisors would face significant hurdles to order these banks to generally diversify their funding base or to raise red flags about risk management of the specific FTX and Binance customer accounts. Doing so would unquestionably discourage specific customer relationships—activity that would be prohibited. When a bank's reputation suffers depositors and counterparties lose confidence in the bank and flee.

Third, sale of complex structured financial products in the run-up to the 2008 financial crisis. Banks created and offered exotic investments like synthetic collateralized debt obligations, which blew up and collapsed the financial system. During that period, the agencies issued supervisory guidance noting that banks involved in these transactions have "sustained significant legal and reputational harm" and laid out how banks should manage the associated risks. Several big banks ultimately guaranteed those toxic financial products for reputational reasons, rather than stick their customers with losses. Those financial guarantees eroded these banks' capital and led to government bailouts. This example demonstrates how, in the agencies' words from that period, "a bank might incur losses affecting capital adequacy because of damage to its reputation." If the proposal were finalized, the agencies would have faced significant hurdles to address this issue because their supervisory approach evaluated reputation risk.

The agencies' proposal appears to be based on revisionist history of "Operation Chokepoint," an initiative by the Department of Justice to target fraudulent practices in the financial system stemming from banks' relationships with merchants having high incidences of

chargebacks and other indicia of fraud. But according to an OCC press release from 2019, "the agency did not participate in 'Operation Choke Point' or in any purported conspiracy to force banks to terminate the bank accounts of plaintiffs or of other payday lenders." And the FDIC's Inspector General found the agency's involvement was "within the Corporation's broad authorities," "limited to a few FDIC staff," and "inconsequential to the overall direction and outcome of the initiative."

Nonetheless, when settling litigation around "Operation Chokepoint" in 2019, the FDIC under the leadership of then-chair Jelena McWilliams published specific policies for all supervisors to follow regarding when and how to invoke reputational risk. Specifically, the FDIC "placed clear limitations on the ability of any [agency] personnel to recommend the termination of account relationships," including that "no recommendation should be made to terminate an account relationship based solely on reputational risk to the institution." The OCC did not make any public changes to its supervisory programs.

The agencies claim that this proposal will enable regulators "to refocus bank supervision on material financial risks and to eliminate politicized debanking." However, the agencies have provided no evidence that supervisors have ordered banks to cut ties with specific customers based on political, social, cultural, or religious beliefs. By going much further than the 2019 FDIC policy to write reputational risk out of bank supervision entirely, the proposal actually appears designed to address illusory claims of "debanking" of President Trump's family, donors, and allies, who have enjoyed continued access to all kinds of banking products, including bank accounts that they use to receive income and pay expenses.

Over the past year, the FDIC and OCC have reduced the effectiveness of bank supervision. Slashing supervisory staff while implementing policies that make it more difficult for remaining supervisors to crack down on misconduct and excessive risk-taking is a recipe for disaster. You are sending an unambiguous message that supervisors should think twice before taking prompt and aggressive action to curb risky behavior. Rather than deterring supervisors from asking hard questions, you should be empowering supervisors to be more forceful and not to hold back their criticisms. Doing so will ensure that supervisors have every tool in the box to curb risky activity before it causes actual financial harm to individual banks, the financial system and, ultimately, the taxpayers who have been asked time and time again to bail out banks and the system when they get into trouble.

Thank you for your consideration of these comments.

Sincerely,

[redacted]

Jack Reed
United States Senator

[redacted]

Elizabeth Warren
Ranking Member
Committee on Banking,
Housing, and Urban Affairs