Federal Reserve Notice of Proposed Rulemaking
"**Prohibition on Use of Reputation Risk or Other Supervisory Tools to Encourage or Compel Banking Organizations to Engage in Politicized or Unlawful Discrimination**"
12 CFR Part 262
[Docket No. R-1884]
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Comment of Richard Morrison[1]
Senior Fellow, Competitive Enterprise Institute[2]

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Introduction

The Competitive Enterprise Institute (CEI) is pleased to have the opportunity to comment on the Federal Reserve's current notice of proposed rulemaking, "Prohibition on Use of Reputation Risk or Other Supervisory Tools to Encourage or Compel Banking Organizations to Engage in Politicized or Unlawful Discrimination." Since 1984, CEI has published research in support of free markets and limited government and has long advocated for policies that increase consumer choice, free business owners from government interference, and protect Americans from abuse by government agencies. CEI policy experts frequently comment on a wide variety of economic policy topics, including finance, regulatory reform, and property rights.

Background on Debanking and Weaponization

The debate over debanking and what has been termed the "weaponization" of financial regulation for political purposes goes back, in its current form, to the presidency of Barack Obama and the implementation of what was known as "Operation Choke Point" (OCP). This involved federal banking regulators pressuring bank executives into cutting off financial services to small business clients, in particular through their relationships with third-party payment processors. The businesses in question were largely engaged in, in the framing of the current Notice of Proposed Rulemaking (NPRM), "politically disfavored but lawful business activities."

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[1] Richard Morrison is a senior fellow at the Competitive Enterprise Institute. He has been working in research and communications roles in the liberty movement since 1999 and has written extensively on financial regulation, in particular the topics of politicized investing and environmental, social, and governance (ESG) theory. He is the host of the *Free the Economy* podcast and the editor of the *Great Capitalism* newsletter. He holds a B.A. in Government from Claremont McKenna College.

[2] The Competitive Enterprise Institute (CEI) is a think tank in Washington, D.C. focused on free-market policy analysis. Founded in 1984, CEI is America's leading advocate of regulatory reform on a wide range of policy issues.

As CEI Vice President for Strategy Iain Murray wrote in a study examining OCP in 2014, "As a result, many companies and individuals that have done nothing wrong have been frozen out of banking services. Without the links to banks, their financial lifeblood is choked off indeed." Aggressive supervisory activities on the part of the Department of Justice (DOJ), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) thus inflicted significant harm on law-abiding US citizens without due process of law.[3]

While OCP was eventually discontinued after receiving significant negative news media coverage and investigation by the US House Oversight and Government Reform Committee, the road to redress was long.[4] Begun in 2011, it was not until 2017 that the Department of Justice officially committed to ending it, and then only after a change of administration.[5] The FDIC did not reach a settlement until 2019 with payday lenders who had sued to protest their treatment under OCP.[6]

The Board of Governors of the Federal Reserve System should be commended for distancing itself from this unlawful and infamous legacy. Moreover, OCP was by no means a unique or rare instance of government overreach via executive authority. It was conceptually similar to other policies and initiatives in recent years that have attempted to coerce and commandeer, without lawful authority, the management decisions of major US corporations, to the detriment of small business clients, shareholders as a class, and individual US citizens in general.[7]

These include efforts as wide-ranging as climate finance policy intended to damage domestic oil and gas production[8] to attempts to censor public health information during the COVID-19 crisis.[9] It also includes the anti-cryptocurrency initiatives undertaken by the previous administration that have been widely referred to as "Operation Choke Point 2.0,"

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[3] Iain Murray, *Operation Choke Point: What It Is and Why It Matters* (Competitive Enterprise Institute, July 2014), p. 1, https://www.cei.org/wp-content/uploads/2014/08/Iain-Murray-Operation-Choke-Point.pdf.
[4] Committee on Oversight and Government Reform, "The Department of Justice's 'Operation Choke Point': Illegally Choking Off Legitimate Businesses?," US House of Representatives, May 29, 2014, https://oversight.house.gov/wp-content/uploads/2014/05/Staff-Report-Operation-Choke-Point1.pdf.
[5] Victoria Guida "Justice Department to end Obama-era 'Operation Choke Point,'" *Politico*, August 17, 2017, https://www.politico.com/story/2017/08/17/trump-reverses-obama-operation-chokepoint-241767.
[6] "FDIC Resolves Payday Lender Lawsuit," Federal Deposit Insurance Corporation, May 22, 2019, https://www.fdic.gov/news/press-releases/2019/pr19040.html.
[7] Richard Morrison, "How Partisan Bureaucrats Weaponized Financial Regulation," *National Review*, September 9, 2024, https://www.nationalreview.com/2024/09/how-partisan-bureaucrats-weaponized-financial-regulation/.
[8] Rep. Dan Newhouse, "Fighting President Biden's Unprecedented War on American Energy," US House of Representatives, March 21, 2024, https://newhouse.house.gov/media/weekly-columns-and-op-eds/fighting-president-bidens-unprecedented-war-american-energy.
[9] "Zuckerberg says the White House pressured Facebook to 'censor' some COVID-19 content during the pandemic," Associated Press, August 27, 2024, https://www.pbs.org/newshour/politics/zuckerberg-says-the-white-house-pressured-facebook-to-censor-some-covid-19-content-during-the-pandemic.

described by one crypto analyst as a "coordinated, ongoing effort across virtually every US financial regulator to deny crypto firms access to banking services."[10] Current efforts to counter debanking based on reputational risk must be understood as part of this larger policy environment.

Reputational Risk Illegitimate as a Regulatory Tool

The concept of reputational risk, on its own, can be a legitimate tool for individual firms or even individual investors to protect their own public status. An individual with demonstrated links to terrorism or illegal drug financing, for example, will not be someone with whom most banks wish to do business. Similarly, someone managing investments on behalf of an entity associated with the Roman Catholic church may wish to avoid any financial entanglements with a company that provides abortions or distributes pornographic content. In contrast, the asset manager for an environmental activist organization may want to avoid any investments that are associated with deforestation or habitat diversity loss.

As a tool for financial regulation in general, however, reputational risk – especially when associated with businesses that are acknowledged to be legal – is fatally vague and prone to abuse. Unlike profit and loss or, say, interest-rate exposure risk, reputation defies quantification by regulators. Not only can a bank's reputation not be precisely measured, but prior administrations have erred in assuming that they can describe what kind of reputation is desirable for a firm to have in the first place. In addition, since a firm's reputation is subject to the flow of opinion in the public square, it can be negatively engineered – that is, anti-corporate activist groups can (and often do) attempt to engage in character assassination via press release for political and ideological purposes that have nothing to do with financial soundness of the targeted firm.[11]

The reputation that a banking organization may seek to cultivate can vary widely on their value proposition to potential customers and their competitive strategy. Some financial institutions may desire to project an image of being solid, trustworthy, and stable. Others may go out of their way to position themselves as nimble, innovative, and responsive to the latest market opportunities. The same is true for any industry. Customer surveys will no doubt reveal that Starbucks and Black Rifle Coffee Company have very different firm reputations, and an analysis of their management and marketing will demonstrate that those diverging reputations were established and cultivated very much intentionally.[12]

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[10] Nic Carter, "Operation Choke Point 2.0 Is Underway, and Crypto Is In Its Crosshairs," *Pirate Wires*, February 8, 2023, https://www.piratewires.com/p/crypto-choke-point.

[11] Joan E. Greve, "Older Americans protest against 'dirty banks' funding oil and gas projects," *The Guardian*, March 22, 2023, https://www.theguardian.com/us-news/2023/mar/21/dirty-banks-protest-washington-chase-citibank-bank-of-america-wells-fargo.

[12] Maggie BenZvi, "For BRCC, Philanthropy Is More than a Corporate Policy – It's Personal," *Coffee or Die*, March 15, 2020, https://www.coffeeordie.com/article/brcc-mat-best-philanthropy.

Moreover, large firms serving the public broadly may have a variety of customer-facing brands, each with its own emotional associations, advertising strategy, and reputation for quality and service.

Cultivating a corporate and brand reputation is thus itself an expressive act, and regulating it runs the risk of infringing on protected speech. Reputational-risk supervision becomes constitutionally problematic when it operates as vague, informal pressure on banks to deny services to lawful customers because of protected political or religious viewpoints, or when it uses coercion or threatened regulatory consequences to induce private firms to indirectly suppress disfavored associations.[13]

The Board is right to reject use of reputational risk supervision as a vehicle for inducing banks to disfavor lawful customers on ideological grounds. Vague supervisory standards of that sort invite arbitrary enforcement and can become a mechanism for indirect suppression of protected views and associations. The provisions of the proposed rule help ensure that banking organizations are not pressured into decisions that burden the constitutionally protected political or religious associations of lawful customers.

Enforcement of Proposed Policy

The proposed rule effectively covers multiple potential violations, as described in Section II, declaring that it would "explicitly prohibit the Board from encouraging or compelling Board-supervised banking organizations" from engaging in debanking-related activities. One problem with countering the weaponization policies of the recent past is that they were not explicit and clearly announced, making it difficult for affected parties to oppose and counter. The inclusion of "encouraging" rather than simply "requiring" is vital to covering the more "soft law" type applications that flow from guidance, interpretive documents, and face-to-face meetings with regulated parties rather than formal rulemaking.

One of the most pernicious aspects of previous policies like OCP and various jawboning efforts is that they have been too vague and obscure to clearly challenge, even when third parties have been negatively affected. Executive agencies will, by definition, not announce to the public or publish a *Federal Register* notice that they are going to be infringing on the constitutional rights of regulated parties, so any rule needs to explicitly cover any conduct that *might* have the effect of creating such a violation, or merely *encourages* such a violation. Is it cold comfort to inform a citizen, for example, "You can always sue to contest an illegitimate policy" if, according to the agencies in question, no such policy formally exists (but is nonetheless informally being implemented).

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[13] See Supreme Court majority opinions in *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58 (1963) and *National Rifle Association of America v. Vullo*, 602 U.S. 175 (2024).

Restraint from Creating an Affirmative Duty

The proposed rule also contains an important distinction, that "the decision regarding whether or not to [provide services] rests with the banking organization, acting in accordance with applicable law." Some critics of previous debanking policies have, unfortunately, gone too far in their enthusiasm to mediate that harm, proposing to mandate access to banking services regardless of a bank's own independent risk assessment. This would itself be an unjust case of regulatory overreach, albeit in the opposite direction of previous abuses.[14] The current proposed rule rightly omits provisions implementing so-called fair-access mandates on commercial banks and credit unions that had previously been publicly considered.[15]

Proper Consideration of Benefits and Costs in a Deregulatory Environment

In a traditional regulatory cost-benefit analysis an observer's default is to weigh the inevitable costs of a proposed new requirement against the ostensible benefits to be generated to the public. If the utility destroyed by required compliance efforts is less than the dispersed benefits, such a proposal is generally considered to have passed the minimum necessary for further consideration. In an environment in which the emphasis is, unusually, on deregulatory efforts, such an observer has a slightly different task.[16]

With a deregulatory proposal, some observers might be tempted to simply mark its costs as zero, since no new requirements are being imposed. As the Economic Analysis section of the proposed rule notes, however, a policy change of this kind "is expected to generate several economic benefits," and it is equally important to document these benefits as it is to do so with the costs of a rule that imposes a new burden.

The proposal also accurately points out that, beyond the obvious cost-savings of having one fewer rule to comply with, the new proposal would yield dynamic managerial benefits to both regulated entities and the Federal Reserve System itself. Having a laundry list of compliance targets to worry about inevitably means that executives will have less attention to give to those that are most important. There are, unfortunately, many regulatory provisions – like the one being considered in the current rule – that produce little benefit, but compliance with which is still required to avoid potential penalties.

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[14] Nicholas Anthony, "Fair Access to Banking," Cato Institute, Working Paper No. 84, January 1, 2025, https://www.cato.org/working-paper/fair-access-banking.

[15] John Berlau, "Trump EO on debanking is a mixed bag for financial freedom," Open Market (blog), Competitive Enterprise Institute, August 8, 2025, https://cei.org/blog/trump-eo-on-debanking-is-a-mixed-bag-for-financial-freedom/.

[16] "Fact Sheet: President Donald J. Trump Launches Massive 10-to-1 Deregulation Initiative," White House, January 31, 2025, https://www.whitehouse.gov/fact-sheets/2025/01/fact-sheet-president-donald-j-trump-launches-massive-10-to-1-deregulation-initiative/.

This benefit is present on the flip side for compliance officials within federal agencies as well. A federal officer will have less time to attend to their primary enforcement goal if they must also spend time on their 117th most important goal. An environment in which the lowest value goals are eliminated, as with the present proposed rule, will likely yield significant advantages from focusing on higher-value priorities.

Conclusion

The Board is to be commended for moving to formally end reputational risk as a tool of federal bank supervision. Previous efforts at judging regulated entities by this standard were not just unwise but created opportunities for abuse of enforcement authority up to and including the violation of the constitutional rights of regulated parties. These violations were part of a well-documented, long-term effort to force the ideological assumptions and preferences of particular policymakers into corporate management without legislative justification or authorization. The current proposed rule correctly declines to seek a fair-access mandate as redress, while also noting the advantages to both regulated parties and the government that deregulation will yield.