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## Industry Update

# Executive Order Calls for Crackdown on Politicized Debanking

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On August 7, President Donald Trump signed the “Guaranteeing Fair Banking for All Americans” executive order (EO) directing federal banking regulators to investigate financial institutions that have restricted access to financial services on the basis of political or religious beliefs or lawful business activities.

The EO calls for regulators to remove reputational risk from regulatory guidance and to identify and cite institutions that have engaged in politicized or unlawful banking, which will most likely lead to increased supervisory and enforcement activity. Principles that have been tried, true and inherent in governance — in large part due to safety and soundness risk — have been upended by the EO and financial institutions will need to pivot immediately in response. Financial institutions should strongly consider quickly conducting reviews under attorney-client privilege of their policies, procedures and practices, along with a fulsome review of all complaints, that could be viewed as resulting in or evidence of politicized or unlawful debanking.

### Key Aspects of the EO

The EO states that federal banking regulators have used their supervisory authority and other influence over regulated institutions to direct or otherwise encourage politicized or unlawful debanking activities and that financial institutions have engaged in unacceptable practices of politicized or unlawful debanking. The EO defines such practice as directly or indirectly restricting access to, or adversely modifying the conditions of, financial services of customers or potential customers on the basis of their political or religious beliefs or lawful business activities that the financial institution disagrees with or disfavors for political reasons.

The EO states that “no American should be denied access to financial services because of their constitutionally or statutorily protected beliefs, affiliations, or political views, and to ensure that politicized or unlawful debanking is not used as a tool to inhibit such beliefs, affiliations, or political views.” Instead, financial institutions must make banking decisions “on the basis of individualized, objective, and risk-based analyses.”

To rectify such conduct, the EO requires several actions from federal banking regulators, including the Small Business Administration (SBA), Federal Reserve Board (FRB); Office of the Comptroller of the Currency (OCC), Consumer Financial Protection Bureau (CFPB), Federal Deposit Insurance Corporation

(FDIC), and National Credit Union Administration (NCUA). Specifically, the EO directs regulators to take the following actions:

- **Removal of Reputation Risk From Regulatory Guidance**
  - The EO requires regulators to remove the use of reputation risk or similar concepts that could result in politicized or unlawful banking from their guidance documents, manuals and other materials not requiring notice-and-comment rulemaking.
  - The EO also requires regulators to consider rescinding or amending existing regulations that could result in politicized or unlawful banking.
- **Investigating Financial Institutions' Policies and Practices**
  - The EO orders regulators to conduct a review to identify financial institutions that have had any past or current policies or practices that request, encourage or influence the financial institution to engage in politicized or unlawful debanking.
  - The EO calls for regulators to "take appropriate remedial action" if the regulator finds politicized or unlawful debanking that violates applicable law, including federal prohibitions on unfair, deceptive and abusive acts or practices under Section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) or Section 1031 of the Consumer Financial Protection Act (12 U.S.C. § 5531) (UDAP/UDAAP), as well as the Equal Credit Opportunity Act (ECOA). Under the EO, examples of appropriate remedial action include levying fines, issuing consent decrees or imposing other disciplinary measures.
  - The EO also orders regulators to review their supervisory and complaint data to identify financial institutions that have engaged in unlawful debanking on the basis of religion in violation of ECOA and to refer any such matters to the Department of Justice for appropriate civil action.
- **Developing Strategy for Combatting Politicized or Unlawful Debanking**
  - The EO requires the treasury secretary to develop a comprehensive strategy for further measures to combat politicized or unlawful debanking activities of financial regulators and financial institutions, including considering legislative or regulatory options.
- **Identifying and Reinstating Adversely Affected Clients and Potential Clients**
  - The EO orders the SBA to require all financial institutions with which it guarantees loans under its lending programs to: (i) make reasonable efforts to identify and reinstate any previous clients denied service through a politicized or unlawful debanking action; (ii) identify all potential clients denied access to financial services through a politicized or unlawful debanking action and provide notice of the renewed option to engage in the previously denied services; and (iii) identify all potential clients denied access to payment processing services through a politicized or unlawful debanking action and provide notice of the renewed option to engage in the previously denied services.

### **What Can Financial Institutions Expect Going Forward?**

- Financial institutions should be prepared for an influx of actions from federal banking regulators relating to the EO. Regulators have already indicated they will engage in rulemaking to rescind or amend applicable regulations in the coming months and we expect they will issue updated guidance and exam manuals removing references to reputation risk, to the extent that they have not already done so.
  - Following the EO, Comptroller of the Currency Jonathan V. Gould issued a statement providing that "[t]he OCC has already taken initial steps to depoliticize the federal banking system consistent with the President's Executive Order" by removing references to reputation risk from its handbooks and guidance documents. The statement also provided that the OCC will propose a rule removing the reputational risk references from its regulations.

- In response to the EO, FDIC Acting Chairman Travis Hill, stated that the FDIC plans to issue a rulemaking that will prohibit examiners from basing criticism of institutions on reputational risk or telling institutions to close accounts for political, social, religious or other views, and that it plans to evaluate whether FDIC-supervised institutions have engaged in politicized or unlawful debanking.
- The FRB announced in late June that reputational risk will no longer be a component of examination programs in its supervision of banks and that it was removing references to reputational risk from supervisory materials. Interestingly, the FRB noted at the time of the announcement that the changes did not affect how banks use the concept of reputational risk in their own risk management practices. However, the EO makes it clear that banks should evaluate what constitutes reputational risk to ensure factors are not somehow tied to politicized or unlawful banking.
- We anticipate increased supervisory and enforcement activity from federal banking regulators focused on politicized or unlawful banking. Both the OCC and FDIC have already indicated they will begin reviews to assess whether supervised institutions have or are engaging in politicized or unlawful debanking, and we quickly expect the CFPB, FRB, NCUA and SBA to take similar action. The EO lays the groundwork for federal banking regulators to cite politicized or unlawful banking as potential UDAP/UDAAP violations, as well as potential ECOA violations for the use of religious beliefs.
- As provided in the EO, complaints may serve as the basis for investigations by regulators. We anticipate regulators will work to identify complaints that provide even the slightest indication that a consumer or business felt they were debanked due to their political, social, religious, or other views or business activities, and that such complaints will be used as a basis for supervisory and enforcement action.
- While the EO directs regulators to identify and address unlawful debanking by financial institutions, President Trump's public comments and now this EO regarding politicized and unlawful debanking may touch off a new wave of activity by private litigants who believe they have been unlawfully debanked or otherwise mistreated due to their political or religious beliefs.

### **What Should Financial Institutions Do in Response?**

In preparation, financial institutions should:

- Conduct internal reviews of their policies, procedures and practices to assess any potential risk under the EO. This includes reviewing policies and practices relating to UDAP/UDAAP and ECOA. Internal reviews also should assess any decision-making criteria that may be considered a proxy for political or religious beliefs or lawful business activities. Financial institutions should strongly consider performing such reviews under attorney-client privilege due to the sensitive and inflammatory nature of potential findings.
- Ensure their complaint management systems are capturing, managing and analyzing complaints related to debanking. As part of their internal review, financial institutions also should conduct a review of any complaints they have received alleging debanking on the basis of religion, as well as on the basis of political beliefs and lawful business activities as described in the EO.
- Carefully monitor industry litigation trends, especially litigation filed by individual consumers or businesses. While the EO directs regulators to move quickly in assessing unlawful debanking, litigation will likely be an early indicator of the types of treatment and activities consumers and businesses believe to be unfair or unlawful, which will likely shape regulators' assessment as well.

Please reach out to the Paul Hastings team if you have questions as you navigate the potential impact of the EO and the evolving federal regulatory landscape.

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