July 30, 2018

House Financial Regulatory Legislation

Banking and Insurance Provisions of the "JOBS and Investor Confidence Act of 2018"

On July 17, the U.S. House of Representatives voted 406 to 4 to pass **S. 488**, the "JOBS and Investor Confidence Act of 2018," which is "comprised of 32 individual pieces of legislation that have passed the House Financial Services Committee or the House this Congress with broad bipartisan support."[1] The House Financial Services Committee characterizes the legislation as "the third and largest installment of 'Jumpstart Our Business Startups (JOBS) Act' legislation aimed at helping small businesses, entrepreneurs and investors by reforming our capital markets."[2] Although most of the provisions in the legislation are aimed at promoting new capital formation (we have analyzed these provisions in a separate **client memorandum**), the package includes several other financial regulatory provisions that would:

- Amend the Dodd-Frank Act to require bank holding companies ("BHCs") to submit resolution plans (often referred to as "living wills") to the Federal Reserve Board and the FDIC every two years, rather than annually, and to require agencies to provide feedback regarding a submitted resolution plan within six months of its submission;[3]
- Increase the maximum percentage that a national bank, member bank of the Federal Reserve System, nonmember insured bank, or Federal savings association is permitted to invest in a small business investment company from 5 percent to 15 percent of its capital and surplus;
- Provide a safe harbor from liability under the Bank Secrecy Act for financial institutions that maintain a customer account at the request of a federal, state, tribal, or local law enforcement agency;
- Require the Federal Reserve, FDIC, and OCC to implement a risk-adjusted approach to valuing centrally-cleared, exchange-listed derivatives for purposes of determining capital requirements for banking organizations; and
- Seek to "ensure[] that international insurance standards and agreements are consistent with our domestic insurance system and provide[] greater Congressional oversight and transparency on international insurance standard negotiations."

Each of these provisions is discussed below. The legislation now moves to the Senate, where it could take several different procedural paths. If passed by the Senate without further amendment, the bill

would go directly to the President for his signature. White House Press Secretary Sarah Huckabee Sanders expressed President Trump's support for the legislation but noted that the White House intends to seek "several technical and substantive changes."[4] After the House acted, Senate Majority Leader Mitch McConnell stated, "[n]ow that the House has passed their bipartisan legislation to improve access to capital for communities across the country as they grow and create jobs, senators will continue their ongoing bipartisan discussions as we work towards a vote in the coming months."[5] Accordingly, although procedural and political hurdles remain, especially in the Senate, we believe the House-passed bill—or legislation substantially similar to that bill—has reasonable prospects for enactment before the end of this Congress.

Financial Regulatory Measures

If enacted, the bill would:

- ***Amend Dodd-Frank to require BHCs to submit resolution plans only every two years.*** The bill would amend Section 165(d) of the Dodd-Frank Act to (1) direct the Federal Reserve and the FDIC to require bank holding companies (and nonbank financial companies supervised by the Federal Reserve) to submit a resolution plan "every 2 years" rather than "periodically" (thus excluding the possibility of an annual submission requirement), and (2) require the Federal Reserve and the FDIC to provide feedback on the submitted resolutions plans "not later than the end of the 6-month period beginning on the date the company submits the resolution plan." The bill would also require the Federal Reserve and the FDIC to publicly disclose the assessment framework each uses to review these resolutions plans.
  - With respect to "an appropriate Federal banking agency that requires a banking organization to submit to the agency a resolution plan not described under section 165(d) of the [Dodd-Frank Act]," the bill would require that each appropriate Federal banking agency (1) ensure that its review of such plans is consistent with the requirements of these amendments, (2) require submission of such plans no more often than every two years, and (3) apply paragraphs (6) and (7) of Section 165(d) to such resolutions plans.[6]
- ***Increase the maximum investment that a financial institution or Federal savings association is permitted to make in a small business investment company.*** The bill would amend Section 302(b) of the Small Business Investment Act of 1958,[7] which currently allows national banks, member banks of the Federal Reserve System, nonmember insured banks (to the extent permitted under applicable State law), and Federal savings associations to invest no more than 5 percent of their capital and surplus in small business investment companies. The proposed amendments would allow these entities to invest up to 15 percent of their capital and surplus in small business investment companies, provided that the investor obtains approval from the appropriate Federal banking agency.[8]
- ***Provide a safe harbor for financial institutions that maintain a customer account at the request of a law enforcement agency.*** Under the Bank Secrecy Act and anti-money laundering regulations, financial institutions are subject to severe penalties for maintaining accounts that are used to facilitate illegal activities. Financial institutions often receive notices from law enforcement agencies, known as "keep open" letters, requesting them to keep an account open so that they can track payments and better monitor criminals. If a financial institution assists law enforcement by complying with a keep open letter request, it may face the risk of regulatory enforcement actions for allowing an account to be used for criminal purposes. The bill would add a statutory safe harbor from liability (under the Bank Secrecy Act, which carries criminal penalties for violations[9]) with respect to keep open letters if a federal, state, tribal, or local law enforcement agency requests, in writing, that the financial institution keep an account or transaction open.

- The proposed amendment would protect a financial institution from liability for maintaining an account consistent with the parameters of such a request and would prevent a federal or state department or agency from taking any "adverse supervisory action" under the Bank Secrecy Act with respect to the financial institution for maintaining an account or transaction consistent with the parameters of the request. The limitation of the proposed safe harbor to liability or adverse supervisory action under the Bank Secrecy Act alone could leave open, however, the possibility that the Federal banking agencies could take action under Section 8 of the Federal Deposit Insurance Act.

- In 2007, the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of the Treasury, in consultation with the staffs of many impacted federal agencies,[10] issued guidance on keep open letters, specifying that financial institutions should require that a keep open request be made in writing by a "supervisory agent" or attorney, with a duration not exceeding six months.[11] The proposed amendment similarly requires that a request be made "in writing" and provides that it should not be construed to "relieve a financial institution from complying with any reporting requirements, including the reporting of suspicious transactions under [31 U.S.C. § 5318(g)]," but it does not specify that requests be made by certain supervisory agents or that requests be limited to a duration of six months.

- ***Require prudential regulators to implement a risk-adjusted approach to valuing centrally-cleared, exchange-listed derivatives for purposes of determining capital requirements.*** Under the current U.S. risk-based capital rules, a banking organization that clears derivatives for clients and guarantees the client's performance to the central counterparty is required to calculate risk-based capital requirements in respect of its exposure to the client. The banking organization's exposure to the client generally is treated as an over-the-counter derivatives contract for these purposes. The bill would require the Federal Reserve, the FDIC, and the OCC jointly to issue a proposed rule (within 180 days of the bill's enactment) to adopt a methodology (under applicable capital rules) for calculating counterparty credit risk exposure at default for a banking organization[12] to a client "arising from a guarantee provided by a [banking organization] to a central counterparty" with respect to the client's performance under an exchange-listed, centrally-cleared derivatives contract.

  - In issuing the rule, the agencies would be required to consider 10 enumerated factors, including: (1) the availability of liquidity provided by market makers during times of high volatility in the capital markets, (2) the preference for and benefits of clearing through central counterparties, (3) the safety and soundness of both the financial system and of individual institutions that may centrally clear exchange-listed derivatives or options, including concentration of market share, (4) barriers to entry for depository institutions, their holding companies, and affiliates (and entities not affiliated with a depository institution) to centrally clear exchange-listed derivatives or options on behalf of market makers, and (5) the impact any changes may have on the broader capital regime and aggregate capital in the system.

  - The agencies would be required to finalize this rule within 360 days of the bill's enactment.

- ***Seek to ensure state-level participation and greater Congressional oversight and transparency regarding international insurance standards negotiations.*** The bill would place prohibitions and requirements on individuals representing the federal government in "any international regulatory, standard-setting, or supervisory forum or in any negotiations of any international agreements" relating to prudential insurance. Specifically, the Act would require any such federal representatives to involve state insurance regulators in their negotiations, and consult with and report to Congress prior to entering into any such agreement. To accomplish this, the Act would amend a number of provisions in 31 U.S.C. §§ 313-14, which governs the Federal Insurance office, to reflect these reporting requirements and prevent the Federal Insurance office from entering into retrospective covered agreements.

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ENDNOTES

1 House Financial Services Committee, Press Release, House Passes Bipartisan "JOBS & Investor Confidence Act" (Jul. 17, 2018), *available at* https://financialservices.house.gov/news/email/show.aspx?ID=7UD3NQFEEE64BPYFPVE5Z6WSBQ (hereafter, the "HFSC Press Release").

2 HFSC Press Release.

3 The currently applicable, jointly issued resolution plan implementing regulation, 12 C.F.R. Part 243 (Federal Reserve) and 12 C.F.R. Part 381 (FDIC), requires subject banking organizations to submit annual resolution plans; however, the Federal Reserve and the FDIC have extended annual resolution plan submission deadlines (making submissions effectively bi-annual) on several occasions. *See, e.g.*, Federal Reserve and FDIC, Joint Release, *Agencies Announce Joint Determinations for Living Wills* (Dec. 19, 2017) (extending the deadline from July 1, 2018 to July 1, 2019), *available at* https://www.fdic.gov/news/news/press/2017/pr17099.html; Federal Reserve and FDIC, Joint Release, *Agencies Extend Deadline for 38 Resolution Plan Submissions* (Aug. 2, 2016) (extending the deadline from December 31, 2016 to December 31, 2017), *available at* https://www.fdic.gov/news/news/press/2016/pr16063.html; and Federal Reserve and FDIC, Joint Release, *Agencies Extend Deadline for Certain Foreign Banking Organizations' Resolution Plan Submissions* (June 8, 2016) (extending the deadline from July 1, 2016 to July 1, 2017), *available at* https://www.fdic.gov/news/news/press/2016/pr16048.html.

Two of these extensions were announced by the agencies within five to seven months of the would-be due date for plan submissions—and one was announced less than one month in advance of the would-be due date—hindering advance planning and resource allocation for subject banking organizations.

4 *See* White House, Statement from the Press Secretary on the Passage of S. 488 (Jul. 17, 2018), *available at* https://www.whitehouse.gov/briefings-statements/statement-press-secretary-s-488-jobs-investor-confidence-act-2018/.

5 Lane, Sylvan, The Hill, "House passes bipartisan bill to boost business investment" (Jul. 17, 2018), *available at* http://thehill.com/business-a-lobbying/397528-house-passes-bipartisan-bill-to-boost-business-investment.

6 Paragraph (6) of Section 165(d) of the Dodd-Frank Act provides that "[a] resolution plan submitted in accordance with [165(d)] shall not be binding on a bankruptcy court, a receiver appointed under subchapter II, or any other authority that is authorized or required to resolve the nonbank financial company supervised by the [Federal Reserve], any bank holding company, or any subsidiary or affiliate of the foregoing." Paragraph (7) of Section 165(d) of the Dodd-Frank Act provides that "[n]o private right of action may be based on any resolution plan submitted in accordance with this subsection."

7 15 U.S.C. § 682(b).

8 The definition of an "appropriate Federal banking agency" would be taken from Section 3 of the Federal Deposit Insurance Act (codified at 12 U.S.C. § 1813(q)).

9 31 U.S.C. §§ 5311 *et seq.*

10 FinCEN issued the guidance in consultation with the staffs of the Department of Justice, the Federal Bureau of Investigation, the Internal Revenue Service's Criminal Investigation Division, the United States Secret Service, the Bureau of Immigration and Customs Enforcement, the Drug Enforcement Administration, the Federal Reserve System, the Office of the Comptroller of the Currency, the FDIC, NCUA, the Commodity Futures Trading Commission, and the SEC.

11 Department of the Treasury, Financial Crimes Enforcement Network, Guidance, FIN-2007-G002, Requests by Law Enforcement for Financial Institutions to Maintain Accounts (June 13, 2007), *available at* https://www.sec.gov/about/offices/ocie/amlmf/fin-2007-g002.pdf. This guidance notes

ENDNOTES (CONTINUED)

that "the decision to maintain or close an account should be made by the financial institution in accordance with its own standards and guidelines," and reminded financial institutions that "as part of their Bank Secrecy Act/Anti-Money Laundering compliance program requirement, they are required to have written policies, procedures, and processes that, among other things, address the identification and reporting of suspicious activity [and if] the financial institution chooses to maintain the account, it is required to comply with all applicable Bank Secrecy Act recordkeeping and reporting requirements, including the requirement to file Suspicious Activity Reports, even if the bank is keeping an account open or maintaining a customer relationship at the request of law enforcement." This guidance also specifies that a request from law enforcement should be a "written request … issued by a supervisory agent or by an attorney within a United States Attorney's Office or another office of the Department of Justice," or, if from a state or local agency, "from a supervisor of the state or local law enforcement agency or from an attorney within a state or local prosecutor's office." The guidance further provides that the duration of the request should not exceed six months.

[12] A depository institution, depository institution holding company, or affiliate with respect to the capital rules of the respective Federal banking agencies codified at 12 C.F.R. Parts 3 (OCC), 217 (Federal Reserve), and 324 (FDIC).

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