SULLIVAN & CROMWELL LLP

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Implementation of Financial Services Regulatory Reform Legislation

Federal Banking Agencies Release Statements on How They Will Implement Provisions of the Economic Growth, Regulatory Relief, and Consumer Protection Act That Have Immediate Effect

SUMMARY

On July 6, the three Federal banking agencies—the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency (the "OCC")—issued an interagency statement (the "Interagency Statement") describing how the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") will affect their positions on certain rules and other requirements that are jointly administered by the three agencies. Also on July 6, the Federal Reserve released a separate statement (the "Federal Reserve Statement") describing how EGRRCPA would affect its positions regarding certain regulations and other requirements administered solely by the Federal Reserve.

The two statements address the implementation of aspects of EGRRCPA that became effective at, or shortly after, the date of enactment of the legislation. Most notably, the statements address the impact of an initial increase in the asset threshold (often referred to as the "SIFI" threshold) above which the Federal Reserve is required to apply the "enhanced prudential standards" ("EPS") in Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

BACKGROUND

EGRRCPA was originally introduced in the Senate by Banking Committee Chairman Mike Crapo (R-ID) and cosponsored by a bipartisan group of Senators. After the bill's approval by the Senate and House of Representatives, President Trump signed the legislation into law on May 24, 2018. As discussed in our

Memorandum to Clients published on that date, EGRRCPA preserved the fundamental elements of the post-Dodd-Frank regulatory framework, but, among other effects of the legislation, included modifications that will result in some meaningful regulatory relief for smaller and certain regional banking organizations. Of particular note, the legislation increases the SIFI threshold in two stages; from $50 billion to $100 billion as of May 24, the date of enactment, and then from $100 billion to $250 billion 18 months after the date of enactment.

Because EGRRCPA does not itself amend the regulations the Federal banking agencies have promulgated to implement EPS, the agencies must amend their existing regulations to account for the new thresholds and other statutory changes. Further, the legislation does not itself directly affect other post-crisis regulatory requirements that were established under (but not required by) Dodd-Frank or were established under other legal authorities. The Federal banking agencies must also amend these regulations to the extent the agencies seek to revise these requirements to mirror the asset thresholds in EGRRCPA.

THE STATEMENTS

The Interagency Statement describes positions that the three Federal banking agencies intend to take with respect to "rules and associated reporting requirements" jointly administered by the agencies that were "immediately" affected by EGRRCPA. The Federal Reserve Statement similarly outlines positions that the Federal Reserve expects to take with respect to rules and reporting requirements it alone administers that were also "immediately" affected by EGRRCPA. The positions described in the two statements are mutually consistent, and the agencies note that they intend to take these positions until the relevant regulations are amended.

The positions addressed in the two statements include the following:

- ***Company-Run Stress Tests.*** EGRRCPA exempts bank holding companies ("BHCs"), banks, savings and loan holding companies ("SLHCs"), and savings associations with less than $250 billion in total consolidated assets from the Dodd-Frank company-run stress testing ("DFAST") requirement. This provision became effective immediately upon enactment for BHCs with less than $100 billion in total consolidated assets, but is effective 18 months after enactment for other institutions—banks, SLHCs, and savings associations—that are also below the $100 billion asset threshold. The agencies address this difference in effective date by delaying, until 18 months after EGRRCPA's enactment, the deadline for all regulatory requirements relating to company-run DFAST for institutions with less than $100 billion in total consolidated assets. This relief effectively renders all institutions under the $100 billion asset threshold, and not just BHCs, exempt from company-run DFAST as of the enactment of EGRRCPA.
- ***Resolution Plans.*** According to the Interagency Statement, the FDIC and Federal Reserve will not enforce resolution planning requirements "in a manner inconsistent with" EGRRCPA's amendments to EPS. Accordingly, institutions with less than $100 billion in total consolidated assets are immediately exempt from the resolution plan filing requirement in Dodd-Frank Section 165(d).[1] The Interagency Statement does not address, however, whether insured depository institutions with less than $100 billion in total consolidated assets remain subject to the FDIC's rule—which was enacted separately from the EPS requirements in Section 165 and not directly affected by EGRRCPA—under

which insured depository institutions with total consolidated assets of $50 billion or more must submit a resolution plan to the FDIC.[2]

- ***Other Prudential Statements That Reflect Dodd-Frank Asset Thresholds.*** The Federal Reserve Statement provides that, "[c]onsistent with the text and purpose of EGRRCPA," the agency will not take action to require BHCs with less than $100 billion in total consolidated assets—including companies that are treated as a BHC for purposes of Section 8 of the International Banking Act of 1978 (*i.e.*, those companies known as "foreign banking organizations" or "FBOs")—to comply with certain regulatory requirements. This relief effectively exempts Federal Reserve-regulated institutions with total global consolidated assets of less than $100 billion from all EPS and certain other prudential regulation as of the enactment of EGRRCPA. The following summarizes the requirements from which institutions are exempt:
    - *BHCs (including FBOs) with less than $50 billion in total global consolidated assets*: company-run stress testing, risk committees (for publicly traded BHCs), and associated reporting and recordkeeping requirements;
    - *BHCs with between $50 billion and $100 billion in total global consolidated assets*: the comprehensive capital analysis and review ("CCAR") process, resolution planning, the modified liquidity coverage ratio ("LCR"), liquidity-related disclosures, qualitative liquidity standards (including liquidity risk management and a liquidity buffer based on liquidity stress testing), supervisory stress testing, company-run stress testing, debt-to-equity limits, and associated reporting and recordkeeping requirements;
    - *FBOs with between $50 billion and $100 billion in total global consolidated assets and total U.S. assets of less than $50 billion*: home country capital certifications, home country capital stress testing, liquidity stress testing, resolution planning, debt-to-equity limits, and associated reporting and recordkeeping requirements;
    - *FBOs with between $50 billion and $100 billion in total global consolidated assets and total U.S. assets of $50 billion or more*: home country capital certifications, home country capital stress testing, liquidity buffers based on internal liquidity stress testing, resolution planning, debt-to-equity limits, a top-tier U.S. intermediate holding company ("IHC"), the application of EPS to that IHC (including U.S. Basel III capital requirements, the CCAR process, risk management and risk committee requirements, qualitative liquidity standards, and supervisory and company-run stress testing), and associated reporting and recordkeeping requirements; and
    - *SLHCs with less than $100 billion in total consolidated assets that are not substantially engaged in commercial or insurance activities*: the modified LCR, liquidity-related disclosures, and associated reporting and recordkeeping requirements.
- ***Volcker Rule.*** EGRRCPA makes two amendments to Section 13 of the Bank Holding Company Act (commonly referred to as the Volcker Rule). First, it exempts a banking entity (which is defined to include an insured depository institution, its parent company, and its affiliates) from the Volcker Rule if it has (1) less than $10 billion in total consolidated assets and (2) total trading assets and trading liabilities representing less than 5% of its total consolidated assets.[3] Second, the legislation amends the Volcker Rule's restriction on sponsoring hedge funds and private equity funds to permit such funds to share the name or a variation of the same name of the banking entity that is an investment adviser to the fund so long as (1) the investment adviser is not, and does not share the name or a variation of the same name as, an insured depository institution, a company that controls an insured depository institution, or an FBO and (2) the name does not contain the word "bank." According to the Interagency Statement, the agencies will not enforce the final rule implementing the Volcker Rule in a manner inconsistent with these amendments. The agencies also intend to address the amendments through a separate rulemaking process.
- ***Capital Treatment of Certain Commercial Real Estate Loans.*** Prior to the enactment of EGRRCPA, under the U.S. standardized approach, "high volatility commercial real estate" ("HVCRE") exposures were assigned a 150 percent risk-weight, instead of the 100 percent risk-weight that would

otherwise typically apply if the exposures were not classified as HVCRE exposures. EGRRCPA prescribes that the Federal banking agencies may only require depository institutions to apply a heightened risk-weight to HVCRE exposures if the exposures meet a new definition of "HVCRE ADC loan," which applies to a narrower scope of exposures than the current definition of HVCRE due to the broader exemptions in the definition of HVCRE ADC loan.[4] According to the Interagency Statement, in making risk-based capital calculations, depository institutions may either (1) "use available information to reasonably estimate and report only HVCRE ADC Loans" as subject to the higher, 150 percent risk-weight, with such institutions permitted to "refine these estimates in good faith as they obtain additional information" (no amendments to previously filed regulatory reports are required for institutions that refine previous estimates); or (2) "until the agencies take further action," continue to report and risk-weight HVCRE exposures without application of the new definition of HVCRE ADC loan. Although the relevant provision of EGRRCPA does not, by its terms, apply to BHCs or SHLCs, the Interagency Statement and the Federal Reserve Statement permit BHCs, SHLCs, and intermediate holding companies of FBOs to estimate and report HVCRE exposures using whichever methodology is consistent with the approach taken by their subsidiary depository institutions.

- ***Adjustments to the Liquidity Coverage Ratio for Certain Municipal Securities.*** EGRRCPA directs the Federal banking agencies to amend their LCR rules to classify "investment-grade" and "liquid and readily-marketable" municipal securities as "level 2B" liquid assets under their LCR Rules and "any other regulation that incorporates a definition of the term 'high-qualify liquid asset' or another substantially similar term." The Interagency Statement notes that the agencies intend to engage in rulemaking to address this provision, but that, "[i]n anticipation of implementing these changes," the agencies will not take action against any institution that treats as level 2B assets municipal securities that the institution "believes meet the statutory criteria" in EGRRCPA for such treatment.
- ***Assessments.*** EGRRCPA increases, from $50 billion to $100 billion, the thresholds for assessments, fees, and other charges collected by the Federal Reserve from BHCs, nonbank SIFIs, and SLHCs to fund the Federal Reserve's supervisory and regulatory responsibilities. To implement this provision, the Federal Reserve intends to collect assessments from all assessed companies for the year 2017, but will not collect assessments from BHCs and SLHCs with total consolidated assets of less than $100 billion for the year 2018 and thereafter.
- ***Relief for Appraisals in Rural Areas.*** EGRRCPA provides that an appraisal is, in certain circumstances in which a mortgage originator subject to Federal oversight has had difficulty obtaining an appraisal, no longer required for a transaction valued at less than $400,000 involving real property or an interest in property located in a rural area. The Interagency Statement states that this relief was effective upon enactment of EGRRCPA and the agencies are determining whether further action is necessary.
- ***Examination Cycle.*** EGRRCPA increases, from $1 billion to $3 billion, the threshold for well-capitalized depository institutions that may qualify for an 18-month on-site examination cycle. This increase would apply automatically to institutions that received ratings of "outstanding" at their most recent examinations. EGRRCPA also authorizes the agencies to make corresponding changes for institutions that received ratings of "good" at their most recent examinations. The Interagency Statement notes that the agencies intend to engage in rulemaking to implement these provisions.
- ***Future Rulemakings.*** Both the Interagency Statement and the Federal Reserve Statement note that a number of other changes in EGRRCPA require implementation through rulemaking, which will occur in the future.

The Interagency Statement and the Federal Reserve Statement both stress that the Federal banking agencies will "continue to supervise and regulate financial institutions within their jurisdictions to ensure the safety and soundness of individual institutions and the stability of the broader banking system." As an example of this continued role, although, as noted above, the agencies will no longer require company-run stress testing by financial companies with less than $100 billion in total consolidated assets, "the

capital planning and risk management practices of these institutions would continue to be reviewed through the regular supervisory process."

IMPLICATIONS

The two statements address how the Federal banking agencies will address various changes to the statutory post-crisis regulatory framework that became effective at, or shortly after, enactment of EGRCCPA. The agencies have not yet indicated how EGRRCPA will affect their implementation of various other post-crisis regulatory requirements that were not immediately affected by the legislation, but that also reference or reflect asset thresholds originally codified in Dodd-Frank, such as the $50 billion U.S. non-branch asset threshold for the IHC requirement (for FBOs with $100 billion or more in total global consolidated assets).[5] In particular, the agencies have not addressed how the increase in the SIFI threshold from $100 billion to $250 billion, which will be effective in May 2019, will affect, among other things, regulations implementing EPS and the CCAR process, as well as supervisory expectations for "large" institutions.[6] Conspicuously absent from the Federal Reserve Statement is any reference to the discretionary authority granted to the Federal Reserve under EGRRCPA to exempt, by order, any BHC with between $100 billion and $250 billion from any EPS requirement during the 18-month "off-ramp" period.

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ENDNOTES

1 *See* 12 C.F.R. Parts 243, 381.

2 *See* 12 C.F.R. § 360.10.

3 This exemption does not apply to any insured depository institution that is controlled by a company that itself exceeds the $10 billion and 5% thresholds contained in the Volcker Rule, as amended by EGRRCPA.

4 Of note, the definition of HVCRE ADC loan excludes loans made prior to January 1, 2015 (the effective date of the U.S. standardized approach) and revises the regulatory exemption in the current definition of HVCRE exposure relating to projects in which the borrower meets certain contributed capital requirements and other prudential criteria by, among other things, removing restrictions on the release of internally generated capital and capital contributed in excess of the minimum required for the exemption to apply.

5 The application of EPS to IHCs of FBOs with $100 billion or more in total global consolidated assets is not affected by EGRRCPA and is not addressed by the statements. As a result, such an IHC with between $50 billion and $100 billion in assets remains subject to EPS pursuant to the Federal Reserve's Regulation YY. Further, in connection with the release of the Federal Reserve's final rule on single counterparty credit limits ("SCCL"), staff of the Federal Reserve indicated that the agency is conducting further analysis regarding the application of SCCL and other EPS to IHCs as part of its broader implementation of EGRRCPA; it remains to be seen whether, and if so how, the U.S. non-branch asset threshold might be changed or the application of EPS to IHCs with between $50 billion and $100 billion in assets or between $100 billion and $250 billion in assets might be revised in light of changes to the SIFI threshold and the application of EPS to BHCs with total consolidated assets of between $100 billion and $250 billion. The Federal Reserve staff memorandum accompanying the SCCL final rule is available at https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20180614.pdf. For further information about the staff memorandum and the SCCL final rule, see our Client Memorandum, *Single Counterparty Credit Limits: Federal Reserve Board Finalizes Rule to Establish Single Counterparty Credit Limits*, dated June 18, 2018, available at https://www.sullcrom.com/single-counterparty-credit-limits-federal-reserve-board-finalizes-rule-to-establish-single-counterparty-credit-limits.

6 For a list of key regulations that incorporate Dodd-Frank asset thresholds that are not directly affected by EGRRCPA, see our Client Memorandum, *Financial Services Regulatory Reform Legislation: "Economic Growth, Regulatory Relief, and Consumer Protection Act" is Enacted*, dated May 24, 2018, *available at* https://www.sullcrom.com/financial-services-regulatory-reform-legislation-economic-growth-regulatory-relief-and-consumer-protection-act-is-enacted.

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