May 24, 2018

Financial Services Regulatory Reform Legislation

"Economic Growth, Regulatory Relief, and Consumer Protection Act" is Enacted

SUMMARY

Earlier today, President Trump signed into law the "Economic Growth, Regulatory Relief, and Consumer Protection Act,"[1] which provides certain limited amendments to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), as well as certain targeted modifications to other post-financial crisis regulatory requirements. In addition, the legislation establishes new consumer protections and amends various securities- and investment company-related requirements. The legislation, which enjoyed substantial bipartisan support, was adopted on May 22, 2018, in the U.S. House of Representatives, by a vote of 258 to 159, and in the U.S. Senate, by a vote of 67 to 31, on March 14, 2018.

The legislation preserves the fundamental elements of the post-Dodd-Frank regulatory framework, but it includes modifications that will result in some meaningful regulatory relief for smaller and certain regional banking organizations.

Notable provisions of the legislation include:

- an increase, in two stages, from $50 billion to $250 billion, 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 Dodd-Frank to bank holding companies ("BHCs");
- an exemption from the Volcker Rule for insured depository institutions and their affiliates with less than $10 billion in consolidated assets and low levels of trading assets and liabilities;
- modifications to the Federal banking agencies' Liquidity Coverage Ratio ("LCR") relating to the treatment of certain municipal securities;

- modifications to the Federal banking agencies' Supplementary Leverage Ratio ("SLR") requirements as applied to "custodial banks";
- elimination of the Dodd-Frank company-run stress tests for BHCs, banks, and other "financial companies" with less than $250 billion in assets[2];
- an exemption from the U.S. Basel III-based capital requirements for smaller banking organizations that maintain a "Community Bank Leverage Ratio" of at least 8%-10%;
- a safe harbor for smaller institutions under Dodd-Frank's "ability to repay" mortgage requirements;
- relief for smaller institutions relating to supervision, examination, and regulatory reporting;
- a requirement that credit reporting agencies provide free credit alerts and freezes;
- new "transparency" requirements governing U.S. participation in the development of international insurance regulatory or supervisory standards;
- an increase in the number of individuals who can invest in certain exempt venture capital funds;
- the elimination of a long-standing exemption from registration for investment companies located in Puerto Rico and other U.S. possessions; and
- studies on consumer reporting agencies, cybersecurity threats, algorithmic trading, and Puerto Rico's housing market.

The legislation's increase in the SIFI threshold takes effect immediately for BHCs with under $100 billion in total consolidated assets and generally will become effective 18 months after the date of enactment for BHCs with total consolidated assets of $100 billion or more but less than $250 billion. However, because the legislation does not itself amend the regulations the Federal banking agencies have promulgated to implement the EPS, the agencies will need to amend their existing regulations to account for the new thresholds. That process may take some time, especially for regulations that were issued on an interagency basis. Similarly, the legislation does not itself directly affect other impactful post-crisis regulatory requirements that were not established pursuant to Dodd-Frank but are instead grounded in other legal authorities. The most important of these is the capital plan rule, pursuant to which the Federal Reserve conducts its comprehensive capital analysis and review ("CCAR") process. We expect the Federal banking agencies will revise these requirements to mirror the asset thresholds in the new legislation, but that process could also take some time.

We believe these legislative and regulatory revisions could encourage bank merger and acquisition activity.

DETAILED SUMMARY OF THE LEGISLATION

A. DODD-FRANK ENHANCED PRUDENTIAL STANDARDS

Although the legislation includes a variety of modifications to post-crisis regulatory requirements that apply to banking organizations of all sizes, the most substantial of these modifications are reserved for smaller, midsize, and certain regional banks. Most notably, the legislation raises the BHC asset threshold above which the Federal Reserve is required to apply the EPS set forth in Section 165 of Dodd-Frank.[3] Under Dodd-Frank, the entire suite of EPS was required to be applied to BHCs with $50 billion or more in total consolidated assets, although the Federal Reserve was permitted to tailor the application of more stringent standards.[4] The EPS include:

- resolution planning;
- company-run and supervisory stress testing;
- the U.S. Basel III-based risk-based and leverage capital rules;
- risk management requirements (including requirements, duties, and qualifications for a risk management committee and chief risk officer); and
- liquidity stress testing and buffer requirements.

Attached to this memorandum is a marked copy of Section 165 of Dodd-Frank, reflecting the modifications made by the newly enacted legislation.

1. SIFI Threshold

Section 401 of the legislation raises the $50 billion "SIFI threshold" to $250 billion, but staggers the application of this change based on the size of the covered BHC.

Immediately upon enactment, BHCs with total consolidated assets of less than $100 billion are no longer subject to the requirements of Section 165.

BHCs with total consolidated assets of $100 billion or more but less than $250 billion will no longer be subject to Section 165 requirements effective 18 months after the date of enactment. The Federal Reserve is authorized, however, during the 18-month "off-ramp" period to exempt, by order, any BHC with between $100 billion and $250 billion from any EPS requirement. The Federal Reserve is also granted the discretionary authority to apply any EPS to any BHC or BHCs with between $100 billion and $250 billion in total consolidated assets that are otherwise exempt under the legislation. To do so, however, it must (i) act by order or rule promulgated pursuant to Section 553 of the Administrative Procedure Act (requiring public notice and comment) and (ii) determine that the application of the EPS is "appropriate . . . to prevent or mitigate risks to [U.S.] financial stability" or "to promote the safety and soundness of the [BHC] or [BHCs]," taking into consideration the BHC's or BHCs' capital structure, riskiness, complexity, financial activities, size, and "any other risk-related factors that the [Federal Reserve] deems appropriate."

BHCs with $250 billion or more in total consolidated assets remain fully subject to EPS, as does any domestic BHC identified as a global systemically important BHC ("G-SIB") for purposes of the Federal Reserve's risk-based capital surcharge, regardless of its total asset size.[5]

2. Company-Run Stress Tests

Section 401 of the legislation exempts 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 test requirement.[6] Section 401 is effective immediately for BHCs with less than $100 billion in total consolidated assets, but does not specifically provide for immediate effectiveness of the changes to company-run Dodd-Frank stress tests ("DFAST") for banks, savings associations, or SLHCs with less than $100 billion in total consolidated assets. Similarly, Section 401 does not authorize the Federal banking agencies to exempt banks, savings associations, or SLHCs with total consolidated assets of between $100 billion and $250 billion from company-run DFAST during the 18-month "off-ramp" period. It remains to be seen whether and how the Federal Reserve and the other Federal banking agencies will address the application of DFAST to banks, savings associations, or SLHCs with less than $100 billion in total consolidated assets prior to the end of the 18-month "off-ramp" period, which is when Section 401 generally will become effective, as well as whether there will be any interim relief for banks, savings associations, or SLHCs with total consolidated assets between $100 and $250 billion. Institutions with $250 billion or more in total consolidated assets are still required to conduct these company-run stress tests, but may do so on a "periodic" basis, rather than semiannually for BHCs and annually for other institutions, as previously required. In addition, the legislation eliminates the "adverse scenario" as a required stress test scenario, reducing the minimum number of supervisory scenarios from three (baseline, adverse, and severely adverse) to two (baseline and severely adverse).

3. Supervisory Stress Tests

The legislation eliminates the annual Dodd-Frank supervisory stress testing requirement for BHCs with less than $250 billion in assets, but the Federal Reserve is still required to conduct "periodic" supervisory stress tests for institutions with total consolidated assets of between $100 billion and $250 billion "to evaluate whether such [BHCs] have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions." BHCs with total consolidated assets of less than $100 billion will no longer be subject to statutorily mandated supervisory stress tests. The Federal Reserve will continue to conduct annual supervisory stress tests for BHCs with $250 billion or more in total consolidated assets, but, as noted above, for the company-run stress tests, the legislation eliminates the adverse scenario as a required scenario, reducing the minimum number of supervisory scenarios as described.

4. Risk Committees and Credit Risk Exposure Reports

Section 401 raises the asset threshold for the requirement that a publicly-traded BHC establish a risk committee from $10 billion to $50 billion or more in total consolidated assets.[7] In addition, it also amends Dodd-Frank's requirement that covered BHCs and nonbank SIFIs submit credit exposure reports by permitting, but not mandating, the Federal Reserve to require submission of these reports by BHCs with more than $250 billion in total consolidated assets and nonbank SIFIs.

5. Tailoring of EPS

The legislation requires the Federal Reserve, in applying the EPS to BHCs of any size, to tailor their application based on certain statutory factors. These statutory factors include capital structure, riskiness, complexity, financial activities, and size. The required tailoring can be applied either to an individual BHC or to a category of BHCs. Dodd-Frank permitted—but did not require—such tailoring.

In addition, the legislation includes a rule of construction clarifying that its revisions to Section 165 "shall not be construed to limit . . . authority of the [Federal Reserve], in prescribing prudential standards under Section 165 of [Dodd-Frank] or any other law, to tailor or differentiate among companies on an individual basis or by category," taking into account the same set of factors. This rule of construction also provides that the legislation does not limit the authority of any Federal banking agency to take supervisory, regulatory, or enforcement action "to further the safe and sound operation of a [supervised] institution."

6. Other Dodd-Frank Thresholds

In conjunction with raising the asset thresholds in Section 165, the legislation raises similar asset thresholds to $250 billion in other Dodd-Frank provisions, including:

- the ability of the Financial Stability Oversight Council to determine whether a $50 billion BHC or a nonbank SIFI poses a "grave threat" to U.S. financial stability;
- assessments paid by $50 billion BHCs and nonbank SIFIs to fund the Office of Financial Research; and
- restrictions involving a management official of a nonbank SIFI serving as a management official of a $50 billion BHC or unaffiliated nonbank SIFI.

The legislation also amends the prior notice requirement in section 163 of Dodd-Frank for acquisitions by a $50 billion BHC or nonbank SIFI, raising the threshold to $250 billion, for acquisitions of voting shares of a company with $10 billion or more of total consolidated assets engaged in activities that are financial in nature (*i.e.*, Section 4(k) of the Bank Holding Company Act). In what would appear to be an oversight, however, the legislation does not revise the prior approval requirements in Section 604 of Dodd-Frank for financial holding companies to acquire a company under Section 4(k) of the Bank Holding Company Act "in a transaction in which the total consolidated assets to be acquired . . . exceed [$10 billion]."[8]

The legislation also 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 its supervisory and regulatory responsibilities and requires tailoring of these assessments, fees, and charges for BHCs, nonbank SIFIs, and SLHCs with between $100 billion and $250 billion in total consolidated assets.[9]

The following chart summarizes the modifications in the legislation to the application of required EPS to BHCs, as compared to their application under Dodd-Frank:

Application of EPS to BHCs				
	Dodd-Frank (≥$50B)	Dodd-Frank, as revised (≥$250B & G-SIBs)	Dodd-Frank, as revised ($100B–$250B)†	Dodd-Frank, as revised (<$100B)
Company-run stress tests	✓ (semi-annually under at least 3 scenarios; annually if BHC $10B–$50B)	✓ (periodically under at least 2 scenarios)	✗	✗
Supervisory stress tests	✓ (annually under at least 3 scenarios)	✓ (annually under at least 2 scenarios)	✓ (periodically)	✗
Risk committee (for publicly-traded BHCs)	✓ (including BHCs >$10B)	✓	✓	✓ (including BHCs >$50B)
Overall risk management	✓	✓	✗	✗
Liquidity requirements‡	✓	✓	✗	✗
Resolution planning	✓	✓	✗	✗
Single counterparty credit limits	✓	✓	✗	✗
Contingent capital	✓	✓	✗	✗
Short-term debt limits	✓	✓	✗	✗
Early remediation	✓	✓	✗	✗

† Following the 18-month off-ramp and subject to Federal Reserve exemption of EPS during that period.

‡ The Federal Reserve has adopted two sets of liquidity requirements as EPS under Section 165: the liquidity risk management and buffer requirements set forth in Regulation YY and the liquidity coverage ratio set forth in Regulation WW. A modified version of the liquidity coverage ratio applies to BHCs with total consolidated assets of $50 billion or more but less than $250 billion and on-balance-sheet foreign exposure of less than $10 billion.

B. OTHER BANK CAPITAL AND LIQUIDITY REFORMS

In addition to modifying the EPS, the legislation makes certain changes to bank capital and liquidity requirements:

1. Adjustments to the Supplementary Leverage Ratio for "Custodial Banks"

Section 402 requires the Federal banking agencies to amend their rules implementing the SLR, which became effective on January 1, 2018,[10] to specify that funds of a "custodial bank"[11] that are deposited with a central bank, such as the Federal Reserve or European Central Bank, will not be taken into account when calculating the measure of total leverage exposure (*i.e.*, the SLR denominator), but that any amount that exceeds the total value of deposits of the custodial bank that are linked to fiduciary or custodial and safekeeping accounts will be taken into account when calculating the SLR denominator. Because of the bill's narrow definition of "custodial bank," these SLR amendments would appear to apply only to a small number of banking organizations.[12]

2. Adjustments to the Liquidity Coverage Ratio for Certain Municipal Securities

Section 403 directs the Federal banking agencies to amend their LCR rules[13] within 90 days after the date of enactment 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-quality liquid asset' or another substantially similar term." In 2016, the Federal Reserve amended its LCR rule to permit certain municipal securities to be treated as level 2B liquid assets, subject to a number of limitations in addition to the investment-grade and liquid and readily-marketable requirements in Section 403.[14] The Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation (the "FDIC") have not adopted or proposed similar amendments, and their LCR rules do not currently permit municipal securities to be treated as level 2B liquid assets.

3. Capital Treatment of Certain Commercial Real Estate Loans

Under the U.S. standardized approach, exposures that are "high volatility commercial real estate" ("HVCRE") exposures are assigned a 150 percent risk-weight,[15] instead of the 100 percent risk-weight that would otherwise typically apply if the exposures were not classified as HVCRE exposures. Section 214 statutorily prescribes that the Federal banking agencies may only require depository institutions to apply a heightened risk-weight to HVCRE exposures if the exposures meet the definition of "HVCRE ADC loan" set forth in that section, 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. Although Section 214 would not, by its terms, apply to BHCs or SLHCs, the Federal Reserve could determine to apply the narrower definition of "HVCRE ADC loan" to the capital requirements of BHCs and SLHCs as well. Of note, the definition of HVCRE ADC loan excludes loans made prior to January 1, 2015 (the effective date of the 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. In September 2017, the Federal banking agencies released a proposal that would change the current treatment of HVCRE exposures under the U.S. standardized approach by applying a lower 130 percent risk-weight to a newly created category of high volatility acquisition, development, or construction ("HVADC") exposures, which the agencies expected to be a broader scope of exposures.[16] It remains to be seen how the Federal banking agencies will revise that proposal and their regulatory capital rules as a result of Section 214. Open questions include whether the agencies will propose a risk-weight different from the current 150 percent risk-weight for HVCRE exposures or proposed 130 percent risk-weight for HVADC exposures in light of the different scope of exposures captured by the definition of HVCRE ADC loan, as well as whether the Federal Reserve will apply the same definitions and risk-weights to BHCs and SLHCs as for depository institutions.

C. ADDITIONAL POST-CRISIS REFORMS

The legislation also contains numerous other modifications to the Dodd-Frank regulatory framework, most of which are designed to provide regulatory relief for smaller financial institutions. The following are notable highlights:

1. Volcker Rule Exemption for Smaller Institutions

Section 203 exempts a banking entity (which is defined to include not only an insured depository institution, but also its parent company and affiliates) from Section 13 of the Bank Holding Company Act (*i.e.*, the Volcker Rule) if the banking entity 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. Any insured depository institution that is controlled by a company that itself exceeds these $10 billion and 5% thresholds would not qualify for the exemption.

2. Permissible Name-Sharing for Funds under the Volcker Rule

Section 204 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 a company that is 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") and (2) the name does not contain the word "bank."

3. Capital Requirements for Smaller Institutions

Section 201 requires the Federal banking agencies to promulgate a rule establishing a new "Community Bank Leverage Ratio" of 8%-10% for depository institutions and depository institution holding companies, including banks and BHCs, with less than $10 billion in total consolidated assets. If such a depository institution or holding company maintains tangible equity in excess of this leverage ratio, it would be deemed to be in compliance with (1) the leverage and risk-based capital requirements promulgated by the Federal banking agencies; (2) in the case of a depository institution, the capital ratio requirements to be considered "well capitalized" under the Federal banking agencies' "prompt corrective action" regime;

and (3) "any other capital or leverage requirements" to which the depository institution or holding company is subject, in each case unless the appropriate Federal banking agency determines otherwise based on the particular institution's risk profile. In carrying out these requirements, the Federal banking agencies are required to consult with State banking regulators and notify the applicable State banking regulator of any qualifying community bank that exceeds or no longer exceeds the Community Bank Leverage Ratio.

D. SMALL BANK REGULATORY RELIEF

In addition to the provisions above, the legislation revises various regulatory compliance and examination requirements targeted at small, midsize, and certain regional financial institutions:

1. "Ability to Repay" Safe Harbor for Smaller Institutions

Section 101 provides that mortgage loans originated and retained in portfolio by certain insured depository institutions and insured credit unions with less than $10 billion in total consolidated assets are automatically deemed to satisfy the "ability to repay" requirement under the Truth in Lending Act ("TILA"). In order to qualify, the specified insured depository institutions and credit unions must meet certain conditions relating to prepayment penalties, points and fees, negative amortization, interest-only features, and documentation.

2. Relief for Appraisals in Rural Areas

Section 103 provides that an appraisal is no longer required for a transaction valued less than $400,000 involving real property or an interest in property located in a rural area if the mortgage originator, which is subject to Federal oversight, or its agent has contacted at least three certified/licensed appraisers and has documented that no such appraiser was available within five business days beyond customary and reasonable fee and timeliness standards for comparable appraisals, as documented by the originator or its agent, to perform the appraisal in connection with the transaction.

3. Small BHC Regulation and Examination Relief

Section 207 requires the Federal Reserve, within 180 days of the date of enactment, to revise its Small Bank Holding Company and Savings and Loan Holding Company Policy Statement[17] to apply to certain BHCs and SLHCs with pro forma consolidated assets of less than $3 billion—an increase from the current $1 billion threshold. The Federal Reserve retains the authority to exclude any BHC or SLHC from the policy if such action is warranted for supervisory purposes. In addition, Section 210 increases the asset threshold for institutions qualifying for an 18-month on-site examination cycle from $1 billion to $3 billion.

4. Short-Form Call Reports

Section 205 requires the Federal banking agencies to promulgate regulations allowing an insured depository institution with less than $5 billion in total consolidated assets (and that satisfies such other criteria as determined to be appropriate by the agencies) to submit a short-form call report for its first and third quarters.

5. Thrift Conversion Exception

Section 206 permits a Federal savings association with $20 billion or less in total consolidated assets as of December 31, 2017, to elect to operate as a "covered savings association," which would have the same powers as a national bank, subject to the same duties, restrictions, and limitations as a national bank, without having to convert to a national bank charter. A covered savings association is required to conform its activities to those permissible for a national bank (subject to OCC rulemaking) and could continue to operate as a covered savings association even if its total assets were to exceed $20 billion after the date on which it made its election. According to the legislative history, these provisions are intended to remove certain constraints on smaller Federal savings associations, including the statutory commercial lending limits and restrictions under the "qualified thrift lender" test, without requiring these institutions to go through the burdensome process of a charter conversion.[18]

E. INTERNATIONAL INSURANCE STANDARDS

Section 211 requires the Secretary of the Treasury, the Federal Reserve, and the Federal Insurance Office ("FIO") to "support increasing transparency at any global insurance or international standard-setting regulatory or supervisory forum in which they participate," such as meetings of the International Association of Insurance Supervisors ("IAIS") and the Financial Stability Board. Among other requirements, the Treasury Secretary and Federal Reserve Chairman are required to submit a report to and testify before Congress within 180 days of the date of enactment of the legislation regarding their efforts to increase transparency at meetings of the IAIS, and to testify annually through 2024 on the status of and their involvement in discussions at international insurance standard-setting fora.

Section 211 also requires the Treasury, Federal Reserve, and FIO to "achieve consensus positions" with State insurance regulators through the National Association of Insurance Commissioners ("NAIC") before "tak[ing] a position or reasonably intend[ing] to take a position" with respect to international insurance proposals negotiated at such global fora. It is not clear how that consensus would be obtained. Further, before supporting or consenting to the adoption of any "final international insurance capital standard," the Treasury Secretary, Federal Reserve Chairman, and FIO Director, in consultation with the NAIC, are required to conduct a study, subject to notice and comment, on the effects of such proposal or standard on U.S. markets and consumers.

In addition, Section 211 establishes a new "Insurance Policy Advisory Committee on International Capital Standards and Other Insurance Issues" at the Federal Reserve, comprised of up to 21 members representing a "diverse set of expert perspectives from the various sectors of the United States insurance industry."

F. ADDITIONAL BANKING PROVISIONS

The legislation also contains the following banking-related provisions:

1. Increase in HMDA Reporting Thresholds

Section 104 exempts insured depository institutions or insured credit unions from the reporting obligations of the Home Mortgage Disclosure Act ("HMDA") if (1) they originated fewer than 500 closed-end mortgages and fewer than 500 open-end lines of credit in each of the previous two calendar years and (2) have not received a CRA rating of "needs to improve" in each of their two most recent examinations or "substantial noncompliance" in their most recent examination. The current reporting thresholds are 25 closed-end mortgages and 500 open-end lines of credit for 2018 and 2019 and 100 open-end lines of credit beginning in 2020.[19] The bill also requires the Government Accountability Office ("GAO") to perform a "lookback" study within three years of enactment to determine the impact of the changed thresholds on HMDA data.

2. Online Banking

Section 213 authorizes an insured depository institution, insured credit union, or any affiliate thereof to scan and electronically store certain personal information from an individual's driver's license or "personal identification card" when the individual initiates a request online to open an account or obtain a financial product or service. Except as required to comply with Federal anti-money laundering requirements, the institution can use such scans and information only to verify the individual's identity and the authenticity of the license/ID card and to comply with certain record-retention requirements. The legislation explicitly preempts and supersedes any conflicting State law, but only to the extent of such conflict. This provision apparently is aimed at facilitating the use of scanned identification documents when consumers seek to open accounts online or through mobile applications in certain States that currently do not permit the practice.

3. Federal Reserve Surplus Fund

In order to offset the estimated budgetary costs of the legislation,[20] Section 217 requires a reduction of the Federal Reserve Banks' combined surplus fund from $7.5 billion to $6.825 billion. This surplus fund was decreased earlier this year from $10 billion to $7.5 billion as part of the Bipartisan Budget Act of 2018.[21]

4. Report on Puerto Rico's Housing Market

Section 311 directs the GAO to prepare a report within one year of the date of enactment regarding foreclosure, delinquency, and homeownership rates in Puerto Rico before and after Hurricane Maria.

G. CONSUMER PROTECTIONS

In addition to numerous banking regulatory reforms, the legislation contains a number of new consumer protections relating to, among other things, credit reports and student loans. The following are notable highlights:

1. Enhanced Credit Reporting Agency Requirements Relating to Identity Theft and Overall Review of Credit Reporting and Credit Scoring Practices

As a response to the recent Equifax breach, Section 301 requires credit reporting agencies to provide consumers with fraud alerts and freezes on credit at no cost to consumers when identity theft is suspected. Section 302 requires credit reporting agencies to provide free credit monitoring to active-duty military service members.

Section 308 requires the GAO to conduct a review of the "current legal and regulatory structure for consumer reporting agencies and an analysis of any gaps in that structure," as well as a review of error correction mechanisms, data security, and the overall functioning of the credit reporting system. One notable aspect is that the GAO will be studying the responsibilities of "data furnishers" (*e.g.*, banking organizations) to ensure that accurate information is submitted to credit reporting agencies.

Section 310 directs Fannie Mae and Freddie Mac to initiate a selection process for determining whether different or additional credit scoring models should be required in underwriting mortgages that they purchase.

2. Study on Cyber Threats

Section 216 directs the Treasury to conduct a study within one year of the date of enactment on the risks of cyber threats to financial institutions and the U.S. capital markets and how regulators are addressing these risks. Although the directive to conduct this study demonstrates recognition of the problem and requires recommendations on whether additional legal authorities or resources are needed, this provision stops short of directing any specific government action to address this pressing issue.

3. Senior Citizen Financial Exploitation Reporting Immunity

Section 303 provides qualified immunity for reports to supervisory and law enforcement agencies and agencies responsible for adult protective services of suspected elder financial exploitation made by financial institutions and certain of their personnel. The covered personnel, who also receive immunity, include compliance personnel and supervisors, as well as registered representatives, investment advisors, and insurance producers. The immunity is available when the relevant individuals are trained in elder care abuse and when the report is made in good faith and with reasonable care. Covered individuals and their institutions receive immunity from civil or administrative proceedings for the disclosure.

4. Student Loan Default and Rehabilitation Relief

Section 601 amends TILA to prohibit a private education loan creditor from declaring a default or accelerating the debt of the student obligor solely on the basis of a bankruptcy or death of a cosigner. In addition, in the case of the death of the borrower, the holder of the loan must release any cosigner from its obligations within a reasonable timeframe after receiving notice of the borrower's death. Private education loan creditors must also provide the borrower an option to designate an individual to act on his or her behalf in the event of the borrower's death. These requirements are not retroactive and apply only to private education loans entered into after 180 days after the date of enactment.

Section 602 provides that a consumer seeking to rehabilitate a qualified education loan through a financial institution's "rehabilitation loan program" may request that the institution remove a reported default on the consumer's credit report. The terms of the loan program must be approved by the institution's appropriate Federal banking agency and must require, without limitation, that the consumer make consecutive timely monthly payments in a number that, in the institution's assessment, demonstrates "a renewed ability and willingness to repay the loan."

In addition, Section 602 requires the GAO, in consultation with the Federal banking agencies, to conduct a study within one year of enactment regarding these student loan rehabilitation requirements, including their effectiveness, associated costs, and effect on credit reporting accuracy, as well as the risks to safety and soundness posed by the requirements.

H. SECURITIES-RELATED REFORMS

The legislation also revises or addresses certain Federal securities laws and regulations governing securities offerings, securities exchanges, and investment companies. The following are notable highlights:

1. Blue Sky Registration Exemption

Section 501 amends Section 18 of the Securities Act of 1933 (the "Securities Act") to apply the exemption from State regulation of a securities offering to securities designated as qualified for trading in the national market system that are listed, or authorized for listing, on any national securities exchange, rather than certain enumerated securities exchanges.

2. Study on Algorithmic Trading

Section 502 requires the Securities and Exchange Commission (the "SEC") to conduct a study within 18 months of the date of enactment on the risks and benefits of algorithmic trading in U.S. capital markets.

3. Exemption for Qualifying Venture Capital Funds

Section 504 amends Section 3(c)(1) of the Investment Company Act of 1940 (the "ICA") to permit "qualifying venture capital funds" to be exempted investment companies if they have no more than 250 beneficial owners—an increase from the maximum of 100 beneficial owners for all other types of companies. "Qualifying venture capital fund" is defined as a venture capital fund[22] with aggregate capital contributions and uncalled committed capital not exceeding $10,000,000.[23] The exemption is designed to provide relief from registration under the ICA for certain venture capital funds. Funds that rely solely on this amended exemption, however, would still be considered "covered funds" for purposes of the Volcker Rule, restricting "banking entities" from investing in such funds.

4. Offsetting Securities Exchange and Association Fees

Section 505 requires the SEC to offset future fees and assessments required to be paid by a national securities exchange or national securities association to the extent that such exchange or association has previously overpaid such fees or assessments and has informed the SEC of the overpayment within ten years.

5. Eliminate Exemption for Investment Companies in U.S. Territories

Section 506 eliminates a long-standing exemption from registration under the ICA for an investment company organized under the laws of and having its principal place of business in Puerto Rico or another U.S. possession if the company's shares are sold only to residents in the jurisdiction of formation. Although the exemption is eliminated on the date of enactment, the legislation provides a three-year safe harbor for investment companies relying on such exemption and permits the SEC to extend the safe harbor for up to three more years if it determines that the extension is necessary or appropriate in the public interest and for the protection of investors.

6. Compensatory Benefit Plans

Section 507 directs the SEC to amend Rule 701 under the Securities Act, which provides an exemption from registration for securities issued under certain compensatory benefit plans, to increase from $5,000,000 to $10,000,000 (with inflation adjustments) the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which the issuer is required to deliver additional disclosure to investors.

7. Amendments to Regulation A

Section 508 directs the SEC to amend its Regulation A, which provides an exemption from registration for securities offered in certain smaller public offerings, to make it available to companies subject to reporting under Sections 13 or 15(d) of the Securities Exchange Act of 1934, and, for Tier 2 offerings, to deem an issuer that is subject to and in compliance with such reporting to be in compliance with the reporting requirements of Rule 257 of Regulation A.

8. Application of Offering and Proxy Rules to Closed-End Funds

Section 509 requires the SEC to propose within one year of enactment and to finalize within two years of enactment rules permitting closed-end funds that are listed on an exchange or make periodic repurchase offers to use the SEC's offering and proxy rules that are available to other reporting companies, subject to conditions the SEC deems appropriate. In connection with the required rulemaking, the SEC is required to consider the availability of information to investors, including what disclosures constitute adequate information to be designated as a "well-known seasoned issuer." If the SEC fails to meet these deadlines, such closed-end funds will be deemed to be eligible issuers under the SEC's regulations.[24] The legislation also clarifies that nothing in Section 509 shall be construed to limit or impair a registered closed-end fund's ability to distribute sales material pursuant to Securities Act Rule 482.[25]

CERTAIN IMPLICATIONS

A. REGULATORY IMPLEMENTATION BEYOND DODD-FRANK

As noted above, the legislation does not itself directly affect a variety of post-crisis regulatory requirements that incorporate the asset thresholds in Dodd-Frank but were established under (but not required by) Dodd-Frank or were established under other legal authorities. Accordingly, we expect that, although not required to do so, the Federal Reserve and other Federal banking agencies will seek to revise many of these requirements to reflect the asset thresholds and other statutory modifications embodied in the legislation.

The following are several key regulations that are not directly affected by the legislation, but that the Federal banking agencies could, and we expect generally will, modify to conform to the new asset thresholds:

- ***CCAR Process.*** Under Federal Reserve regulations, the CCAR process is currently applicable to BHCs with total consolidated assets of $50 billion or more as well as intermediate holding companies ("IHCs") of FBOs.[26] The Federal Reserve conducts the CCAR process pursuant to the capital plan rule, which is in the Federal Reserve's Regulation Y and is not promulgated under the legal authority of Section 165 of Dodd-Frank.
- ***FBOs.*** FBOs are treated as BHCs for purposes of Section 165 of Dodd-Frank,[27] and, therefore, the increase in the asset thresholds for BHCs applies also to the application of EPS to FBOs. However, under Federal Reserve regulations, the application of EPS to FBOs depends on a number of asset calculations and asset thresholds. Stress-test and risk management requirements applicable to FBOs differ based on whether an FBO has at least $10 billion or $50 billion in total global consolidated assets and, for an FBO with at least $50 billion in total global consolidated assets, whether the FBO also has more than $50 billion in combined U.S. assets. The requirement in those regulations that certain FBOs establish an IHC, which is subject to a set of EPS similar to those applicable to domestic BHCs with $50 billion or more in total consolidated assets, applies based on whether an FBO has $50 billion or more in U.S. non-branch assets.[28] The legislation does not direct the Federal Reserve to review or change these asset calculations for FBOs, nor does the legislation direct the Federal Reserve to retain or revise the relevant asset thresholds.[29]

- ***Volcker Rule.*** Under joint regulations of the Commodities Futures Trading Commission, the FDIC, the Federal Reserve, the OCC, and the SEC that implement the Volcker Rule, several provisions apply based on a $50 billion or $10 billion asset threshold. These provisions include the following:
    - Banking entities with total consolidated assets of $50 billion or more or, in the case of any foreign banking entity, total U.S. assets of $50 billion or more, are subject to enhanced minimum standards for Volcker Rule compliance programs. Among other requirements that do not apply to smaller institutions, the CEO of a banking entity or, in the case of a foreign banking entity, the senior management officer of the U.S. operations who is located in the United States, must make an annual attestation regarding the compliance program.[30]
    - Banking entities with total consolidated assets of $10 billion or more are subject to additional documentation requirements related to "covered funds."[31]
- ***Capital Ratio Disclosure Requirements.*** Under the capital adequacy rules issued by the Federal banking agencies, institutions with $50 billion or more in total consolidated assets are required to make additional public disclosures regarding capital ratios and related calculations. The requirements that apply based on a $50 billion asset threshold do not apply to advanced-approaches institutions subject to separate public disclosure obligations.[32]
- ***Federal Reserve Consolidated Supervision.*** The Federal Reserve issued a new consolidated supervisory framework for "large complex banking organizations."[33] This framework includes objectives related to enhancing resiliency of institutions to lower the probability of their failure or their becoming unable to serve as financial intermediaries, and reducing the impact on the financial system and the broader economy of an institution's failure or material weakness. This framework was meant to conform to key Dodd-Frank provisions, such as the EPS.[34] The framework currently applies to domestic BHCs and SLHCs with total consolidated assets of $50 billion or more and FBOs with combined assets of U.S. operations of $50 billion or more.
- ***Current Federal Reserve Supervisory Proposals.*** In August 2017 and January 2018, the Federal Reserve issued three proposals that would apply based on a $50 billion asset threshold. One of these proposals would provide new guidance on board of director effectiveness for large BHCs, large SLHCs, and non-bank financial companies designated for supervision by the Federal Reserve.[35] Another would establish a new rating system for large BHCs, large SLHCs, and IHCs of FBOs.[36] The third would provide guidance on risk management for large BHCs, large SLHCs, IHCs of FBOs, and the combined U.S. operations of FBOs with combined U.S. assets of $50 billion or more, as well as state member bank subsidiaries of the foregoing.[37]
- ***OCC Heightened Expectations.*** Under its statutory authority to prescribe safety and soundness standards, the OCC issued regulations establishing heightened risk governance standards for large national banks and their boards of directors. These regulations apply principally to insured national banks and other insured OCC-supervised institutions that have total consolidated assets of $50 billion or more.[38]
- ***Insured Depository Institution Resolution Planning.*** Under FDIC regulations, insured depository institutions with total consolidated assets of $50 billion or more must submit a resolution plan (a so-called "living will").[39] This requirement is separate from the EPS requirement in Dodd-Frank Section 165(d) that obligates BHCs subject to EPS to file resolution plans with the Federal Reserve and FDIC.
- ***Non-Bank SIFI Designation.*** For the purpose of determining whether a non-bank financial company should be designated as subject to supervision by the Federal Reserve, the Financial Stability Oversight Council ("FSOC") has released guidance that FSOC will consider designating an institution if the institution has $50 billion or more in total consolidated assets. This guidance expressly notes that the asset threshold was set to be "consistent with the [Dodd-Frank] threshold of $50 billion in assets for subjecting [BHCs] to [EPS]."[40]

B. BANK MERGERS AND ACQUISITIONS

We believe the legislation may encourage bank merger and acquisition activity in at least two ways.

First, we believe that banking organizations below $50 billion in assets have historically been reluctant to undertake mergers that would create a combined company exceeding this $50 billion asset level because of the additional costs and risks inherent in being subject to the EPS regime. Supporting this reluctance, the Federal Reserve had indicated that applications for such mergers would get special scrutiny to assure that the resulting company could in fact satisfy EPS.

Second, there has been a general belief that any applications by a covered BHC to acquire another banking organization would likely receive a heightened degree of scrutiny. In light of the legislation, we would expect that transactions where the resultant institution is below the $250 billion level would be subject to a more normalized review.

* * *

ENDNOTES

[1] *See* Pub. L. No. 115-174 (2018), *available at* https://www.congress.gov/115/bills/s2155/BILLS-115s2155enr.pdf.

[2] Section 401 is effective immediately for BHCs with less than $100 billion in total consolidated assets, but does not specifically provide for immediate effectiveness of the changes to company-run DFAST for banks, savings associations, or SLHCs with less than $100 billion in total consolidated assets. Similarly, Section 401 does not authorize the Federal banking agencies to exempt banks, savings associations, or SLHCs with total consolidated assets of between $100 billion and $250 billion from company-run DFAST during the 18-month "off-ramp" period. It remains to be seen whether and how the Federal Reserve and the other Federal banking agencies will address the application of DFAST to banks, savings associations, or SLHCs with less than $100 billion in total consolidated assets prior to the end of the 18-month "off-ramp" period, which is when Section 401 generally will become effective, as well as whether there will be any interim relief for banks, savings associations, or SLHCs with total consolidated assets between $100 and $250 billion.

[3] *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240 (Mar. 27, 2014), *available at* https://www.gpo.gov/fdsys/pkg/FR-2014-03-27/pdf/2014-05699.pdf.

[4] The regulations implementing these standards use the Dodd-Frank statutory thresholds, except that the U.S. Basel III-based capital rules apply to SIFI and non-SIFI banking organizations and the most stringent aspects of the capital rules—those that apply to advanced approaches banking organizations and G-SIBs—use different thresholds. *See generally* 12 C.F.R. Part 252 (Regulation YY—enhanced prudential standards); 12 C.F.R. Part 217 (Regulation Q—Basel III-based capital rules); and 12 C.F.R. Part 243 (resolution plans). For further information, see our Client Memorandum, *"Enhanced Prudential Standards" for Large U.S. Bank Holding Companies and Foreign Banking Organizations: Federal Reserve Approves Final Rule Implementing Certain Provisions of Section 165 of the Dodd-Frank Act Increasing Supervision and Regulation of Large U.S. Bank Holding Companies and Foreign Banking Organizations*, dated February 24, 2014, *available at* https://www.sullcrom.com/enhanced-prudential-standards-for-large-us-bank-holding-companies-and-foreign-banking-organizations. In addition, the Federal Reserve has identified the LCR—including the modified LCR, which applies to BHCs with total consolidated assets of $50 billion or more but less than $250 billion and on-balance-sheet foreign exposure of less than $10 billion—as an enhanced prudential standard.

[5] *See* 12 C.F.R. § 217.402.

[6] *See* 12 C.F.R. §§ 46.5, 252.14, 252.54, 252.55 and 325.4 (requiring BHCs with $50 billion or more in total consolidated assets to conduct semi-annual stress tests and BHCs with total consolidated assets of more than $10 billion but less than $50 billion, and other banking organizations with total consolidated assets of more than $10 billion, to conduct annual stress tests).

[7] *See* 12 C.F.R. § 252.22. Similarly, under Section 401 of the legislation, the Federal Reserve may, but is not obligated to, require each publicly-traded BHC with total consolidated assets of less than $50 billion to establish a risk committee "as determined necessary or appropriate by the [Federal Reserve] to promote sound risk management practices," a permissive authority the Federal Reserve had under Dodd-Frank with respect to publicly-traded BHCs with total consolidated assets of less than $10 billion.

[8] *See* 12 U.S.C. § 1843(k)(6)(B)(ii).

[9] The legislation requires the Federal Reserve to adjust the amount charged against institutions with between $100 billion and $250 billion in total consolidated assets "to reflect any changes in supervisory and regulatory responsibilities resulting from the [legislation] with respect to each such [institution]."

ENDNOTES (CONTINUED)

10 For more information on the SLR, see our Client Memorandum, *Bank Capital Rules: Federal Reserve Approves Final Rules Addressing Basel III Implementation and, for All Banks, Substantial Revisions to Basel I-Based Rules*, dated July 3, 2013, *available at* https://www.sullcrom.com/Bank_Capital_Rules_Basel_III_7_3_13/, and our Client Memorandum, *Bank Capital: Supplementary Leverage Ratio; Federal Banking Agencies Issue Final Rules Revising the Supplementary Leverage Ratio's Exposure Measure Denominator*, dated September 16, 2014, *available at* https://www.sullcrom.com/bank-capital-supplementary-leverage-ratio-federal-banking-agencies-issue-final-rules.

11 The legislation defines "custodial bank" for these purposes as "any depository institution holding company predominantly engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution subsidiary of such a holding company."

12 In April 19, 2018 testimony before the Senate Banking Committee, Federal Reserve Vice Chairman for Supervision Randal Quarles said that his interpretation of the word "predominantly" in Section 402 is that it "would not include the activities of a firm such as Citi or JPMorgan." He also noted that a "broader solution . . . is required" for the SLR, which he said the Federal Reserve had attempted to address in its April 11, 2018 proposal, released jointly with the OCC, to modify the SLR. *See* Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions, 83 Fed. Reg. 17,317 (Apr. 19, 2018), *available at* https://www.gpo.gov/fdsys/pkg/FR-2018-04-19/pdf/2018-08066.pdf. For more information on the proposal, see our Client Memorandum, B*ank Capital Requirements: Federal Reserve and OCC Propose Amendments to the Enhanced Supplementary Leverage Ratio Requirements for U.S. G-SIBs*, dated April 17, 2018, *available at* https://www.sullcrom.com/bank-capital-requirements-federal-reserve-and-occ-propose-amendments-to-the-enhanced-supplementary-leverage-ratio-requirements-for-us-g-sibs.

13 For more information on the LCR, see our Client Memorandum, *Basel III Liquidity Framework: Federal Reserve Approves Final Rule Implementing Basel III Liquidity Coverage Ratio for Large U.S. Banks*, dated September 9, 2014, *available at* https://www.sullcrom.com/basel-iii-liquidity-framework-federal-reserve-approves-final-rule-implementing-basel-iii-liquidity-coverage-ratio-for-large-us-banks.

14 *See* Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets, 81 Fed. Reg. 21,223 (Apr. 11, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-04-11/pdf/2016-07716.pdf. For more information on these amendments, see our Client Memorandum, *Bank Liquidity Requirements: Federal Reserve Adopts Final Amendment Permitting Inclusion of Certain U.S. Municipal Securities as High-Quality Liquid Assets for Purposes of the Liquidity Coverage Ratio*, dated April 5, 2016, *available at* https://www.sullcrom.com/bank-liquidity-requirements-04-05-2016.

15 *See* 12 C.F.R. §§ 3.32(j), 217.32(j), 324.32(j).

16 That proposed rule would eliminate the exemption for loans with substantial borrower-contributed capital. *See* Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 82 Fed. Reg. 49,984 (Oct. 27, 2017), *available at* https://www.gpo.gov/fdsys/pkg/FR-2017-10-27/pdf/2017-22093.pdf. For further information, see our Client Memorandum, *Bank Capital Requirements: Federal Banking Agencies Propose Capital Rule Simplifications to the Standardized Approach Calculations Primarily to Non-Advanced Approaches Banking Organizations*, dated October 4, 2017, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Bank_Capital_Requirements_October_04_2017.pdf.

17 *See* 12 C.F.R. Appendix C to Part 225.

18 *See* H.R. Rep. No. 115-530, at 2 (2017) (House committee report on the "Federal Savings Association Charter Flexibility Act of 2017," a bill containing similar provisions that was passed by

the House as part of the Financial CHOICE Act of 2017 that was introduced by House Financial Services Committee Chairman Jeb Hensarling (R-TX)).

19 See 12 C.F.R. § 1003.2(g)(1)(v).

20 *See* Congressional Budget Office, *Cost Estimate, S. 2155, Economic Growth, Regulatory Relief, and Consumer Protection Act* (Mar. 5, 2018), *available at* https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/s2155.pdf.

21 Bipartisan Budget Act of 2018, Pub L. No. 115-123, § 30205.

22 The legislation adopts the definition of "venture capital fund" in the SEC's rules under the Investment Advisers Act of 1940. *See* 17 C.F.R. § 275.203(*l*)-1.

23 The legislation requires the SEC to index this amount for inflation once every five years, rounded to the nearest $1,000,000.

24 *See* Securities Offering Reform, 70 Fed. Reg. 44,722 (Aug. 3, 2005), *available at* https://www.gpo.gov/fdsys/pkg/FR-2005-08-03/pdf/05-14560.pdf.

25 *See* 17 C.F.R. § 230.482.

26 *See* 12 C.F.R. §§ 225.1 and 225.8. In January 2017, the Federal Reserve amended its capital plan rule to eliminate the qualitative CCAR assessment for BHCs and IHCs that are not G-SIBs and that have less than $250 billion in total consolidated assets and less than $75 billion in total nonbank assets. For additional information on these amendments, see our Client Memorandum, *Banking Organization Capital Plans and Stress Tests: Federal Reserve Finalizes Elimination of the Qualitative CCAR Assessment for Smaller Firms, Reduction in the* De Minimis *Exception for Additional Capital Distributions, and Other Notable Revisions to Its Capital Plan and Stress Testing Rules*, dated February 1, 2017, *available at* https://www.sullcrom.com/banking-organization-capital-plans-and-stress-tests-02-01-2017.

27 *See* 12 U.S.C. § 5311(a)(1).

28 *See* 12 C.F.R. Part 252, Subparts L, M, N, and O.

29 Earlier versions of the legislation were silent with respect to the treatment of FBOs. During the Senate floor debate, however, a provision was added clarifying that "[n]othing in [Section 401] shall be construed to affect the legal effect" of the Federal Reserve's existing Regulation YY as applied to FBOs with $100 billion or more in total consolidated assets or to limit the Federal Reserve's authority "to require the establishment of an [IHC] under, implement [EPS] with respect to, or tailor the regulation of" FBOs with $100 billion or more in total consolidated assets. Nearly all FBOs with significant U.S. operations (including those subject to the IHC requirement) exceed $100 billion in total global assets.

30 *See* 12 C.F.R. §§ 44.20(c)(2) & app. B(III)(6) to Part 44, 248.20(c)(2) & app. B(III)(6) to Part 248, 351.20(c)(2) & app. B(III)(6) to Part 351; 17 C.F.R. §§ 75.20(c)(2) & app. B(III)(6) to Part 75, 255.20(c)(2) & app. B(III)(6) to Part 255.

31 *See* 12 C.F.R. §§ 44.20(e), 248.20(e), 351.20(e); 17 C.F.R. §§ 75.20(e), 255.20(e).

32 *See* 12 C.F.R. §§ 3.1(c)(4), 3.61-.63, 217.1(c)(5), 217.61-.63, 324.1(c)(4), 324.61-.63.

33 *See* Consolidated Supervisory Framework for Large Financial Institutions, Federal Reserve SR 12-17 / CA 12-14 (Dec. 17, 2012), *available at* http://www.federalreserve.gov/bankinforeg/srletters/sr1217.htm. For additional information on this framework, see our Client Memorandum, *Federal Reserve Supervision: Federal Reserve Updates Consolidated Supervision Framework for Large Financial Institutions*, dated Dec. 27, 2012, *available at* https://www.sullcrom.com/Publication_Federal_Reserve_Supervision.

34 *See* Consolidated Supervisory Framework for Large Financial Institutions, Federal Reserve SR 12-17 / CA 12-14 (Dec. 17, 2012).

ENDNOTES (CONTINUED)

35 *See* Proposed Guidance on Supervisory Expectation for Boards of Directors, 82 Fed. Reg. 37,219 (Aug. 9, 2017), *available at* https://www.gpo.gov/fdsys/pkg/FR-2017-08-09/pdf/2017-16735.pdf. For further information about the proposed guidance, see our Client Memorandum, *Federal Reserve Proposes to Refocus Expectations for Banking Organization Directors on Core Responsibilities: Proposal Recognizes the Distinct Role of the Board as Compared to Management and the Adverse Impact of Unduly Extensive Requirements on the Board's Attention and Effectiveness*, dated August 7, 2017, *available at* https://www.sullcrom.com/federal-reserve-proposes-to-refocus-expectations-for-banking-organization-directors-on-core-responsibilities.

36 *See* Large Financial Institution Rating System, 82 Fed. Reg. 39,049 (Aug. 17, 2017), *available at* https://www.gpo.gov/fdsys/pkg/FR-2017-08-17/pdf/2017-16736.pdf. For additional information about this proposal, see our Client Memorandum, *Federal Reserve Proposes New Rating System: Federal Reserve Proposes to Establish a New Rating System for the Supervision of Large Financial Institutions Designed to Align with the Supervisory Program for Those Institutions and to Enhance the Clarity and Consistency of Supervisory Assessments*, dated August 7, 2017, *available at* https://www.sullcrom.com/federal-reserve-proposes-new-rating-system.

37 *See* Proposed Supervisory Guidance, 83 Fed. Reg. 1351 (Jan. 11, 2018), *available at* https://www.gpo.gov/fdsys/pkg/FR-2018-01-11/pdf/2018-00294.pdf. For additional information about this proposal, see our Client Memorandum, *Federal Reserve Proposes Guidance to Clarify Supervisory Expectations Related to Risk Management for Large Financial Institutions: Proposed Guidance Presents Core Principles for Effective Senior Management, Management of Business Lines, and Independent Risk Management and Controls*, dated January 8, 2018, *available at* https://www.sullcrom.com/federal-reserve-proposes-guidance-to-clarify-supervisory-expectations-related-to-risk-management-for-large-financial-institutions.

38 *See* 12 C.F.R. Appendix D to Part 30. These regulations may also apply to certain smaller OCC-supervised institutions that are affiliates of OCC-supervised institutions subject to the heightened expectations. For additional information on these regulations, see our Client Memorandum, *Heightened Risk Governance Standards for Banks and Bank Boards of Directors: Proposed OCC "Guidelines" Would Establish Heightened Standards for Large National Banks' Risk Governance Frameworks and Boards of Directors, and Accelerate Trends of Regulatory Involvement and Reliance on Enforcement*, dated January 21, 2014, *available at* https://www.sullcrom.com/Heightened_Risk_Governance_Standards_for_Banks_and_Bank_Boards_of_Directors.

39 *See* 12 C.F.R. § 360.10.

40 *See* 12 C.F.R. Appendix A to Part 1310.

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Sec. 165 of Dodd-Frank,
as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act

12 U.S.C. § 5365. Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies[1,2]

(a) In general

(1) Purpose

In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under section 5325 of this title, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than ~~$50,000,000,000~~ $250,000,000,000 that-

(A) are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

(2) Tailored application

(A) In general

In prescribing more stringent prudential standards under this section, the Board of Governors ~~may~~ shall, on its own or pursuant to a recommendation by the Council in accordance with section 5325 of this title, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate.

(B) Adjustment of threshold for application of certain standards

The Board of Governors may, pursuant to a recommendation by the Council in accordance with section 5325 of this title, establish an asset threshold above ~~$50,000,000,000~~

1 The above amendments to Sec. 165 become effective 18 months following the enactment of the legislation, although the amendments become effective upon enactment for bank holding companies with less than $100,000,000,000 in total consolidated assets (Sec. 401(d)(2) of the legislation).

2 Sec. 401(b) of the legislation notes that the amendments to Sec. 165 of Dodd-Frank shall not be construed to limit the "authority of the [Federal Reserve], in prescribing prudential standards . . . to tailor or differentiate among companies on an individual basis or by category" or the "supervisory, regulatory, or enforcement authority of an appropriate Federal banking agency to further the safe and sound operation of an institution under the supervision of the appropriate Federal banking agency."

the applicable threshold for the application of any standard established under subsections (c) through (g).

(C) Risks to Financial Stability and Safety and Soundness

The Board of Governors may by order or rule promulgated pursuant to section 553 of title 5, United States Code, apply any prudential standard established under this section to any bank holding company or bank holding companies with total consolidated assets equal to or greater than $100,000,000,000 to which the prudential standard does not otherwise apply provided that the Board of Governors—

(i) determines that application of the prudential standard is appropriate—

(I) to prevent or mitigate risks to the financial stability of the United States, as described in paragraph (1); or

(II) to promote the safety and soundness of the bank holding company or bank holding companies; and

(ii) takes into consideration the bank holding company's or bank holding companies' capital structure, riskiness, complexity, financial activities (including financial activities of subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate.

(b) Development of prudential standards

(1) In general

(A) Required standards

The Board of Governors shall establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that shall include-

(i) risk-based capital requirements and leverage limits, unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls;

(ii) liquidity requirements;

(iii) overall risk management requirements;

(iv) resolution plan ~~and credit exposure report~~ requirements; and

(v) concentration limits.

(B) Additional standards authorized

The Board of Governors may establish additional prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that include-

(i) a contingent capital requirement;

(ii) enhanced public disclosures, including credit exposure reports;

(iii) short-term debt limits; and

(iv) such other prudential standards as the Board or Governors, on its own or pursuant to a recommendation made by the Council in accordance with section 5325 of this title, determines are appropriate.

(2) Standards for foreign financial companies

In applying the standards set forth in paragraph (1) to any foreign nonbank financial company supervised by the Board of Governors or foreign-based bank holding company, the Board of Governors shall-

(A) give due regard to the principle of national treatment and equality of competitive opportunity; and

(B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

(3) Considerations

In prescribing prudential standards under paragraph (1), the Board of Governors shall-

(A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), based on-

(i) the factors described in subsections (a) and (b) of section 5323 of this title;

(ii) whether the company owns an insured depository institution;

(iii) nonfinancial activities and affiliations of the company; and

(iv) any other risk-related factors that the Board of Governors determines appropriate;

(B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of section 5323 of this title would not result in sharp, discontinuous changes in the prudential standards established under paragraph (1) of this subsection;

(C) take into account any recommendations of the Council under section 5325 of this title; and

(D) adapt the required standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate.

(4) Consultation

Before imposing prudential standards or any other requirements pursuant to this section, including notices of deficiencies in resolution plans and more stringent requirements or divestiture orders resulting from such notices, that are likely to have a significant impact on a functionally regulated subsidiary or depository institution subsidiary of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors shall consult with each Council member that primarily supervises any such subsidiary with respect to any such standard or requirement.

(5) Report

The Board of Governors shall submit an annual report to Congress regarding the implementation of the prudential standards required pursuant to paragraph (1), including the use of such standards to mitigate risks to the financial stability of the United States.

(c) Contingent capital

[no modifications made to subsection (c)]

(d) Resolution plan and credit exposure reports

(1) Resolution plan

The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include-

(A) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

(B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;

(C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and

(D) any other information that the Board of Governors and the Corporation jointly require by rule or order.

(2) Credit exposure report

The Board of Governors ~~shall~~ may require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation on-

(A) the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies; and

(B) the nature and extent to which other significant nonbank financial companies and significant bank holding companies have credit exposure to that company.

(3) Review

The Board of Governors and the Corporation shall review the information provided in accordance with this subsection by each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a).

(4) Notice of deficiencies

If the Board of Governors and the Corporation jointly determine, based on their review under paragraph (3), that the resolution plan of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) is not credible or would not facilitate an orderly resolution of the company under title 11-

(A) the Board of Governors and the Corporation shall notify the company of the deficiencies in the resolution plan; and

(B) the company shall resubmit the resolution plan within a timeframe determined by the Board of Governors and the Corporation, with revisions demonstrating that the plan is credible and would result in an orderly resolution under title 11, including any proposed changes in business operations and corporate structure to facilitate implementation of the plan.

(5) Failure to resubmit credible plan

(A) In general

If a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) fails to timely resubmit the resolution plan as required under paragraph (4), with such revisions as are required under subparagraph (B), the Board of Governors and the Corporation may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary thereof, until such time as the company resubmits a plan that remedies the deficiencies.

(B) Divestiture

The Board of Governors and the Corporation, in consultation with the Council, may jointly direct a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), by order, to divest certain assets or operations identified by the Board of Governors and the Corporation, to facilitate an orderly resolution of such company under title 11, in the event of the failure of such company, in any case in which-

(i) the Board of Governors and the Corporation have jointly imposed more stringent requirements on the company pursuant to subparagraph (A); and

(ii) the company has failed, within the 2-year period beginning on the date of the imposition of such requirements under subparagraph (A), to resubmit the resolution plan with such revisions as were required under paragraph (4)(B).

(6) No limiting effect

A resolution plan submitted in accordance with this subsection 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 Board, any bank holding company, or any subsidiary or affiliate of the foregoing.

(7) No private right of action

No private right of action may be based on any resolution plan submitted in accordance with this subsection.

(8) Rules

Not later than 18 months after July 21, 2010, the Board of Governors and the Corporation shall jointly issue final rules implementing this subsection.

(e) Concentration limits

[no modifications made to subsection (e)]

(f) Enhanced public disclosures

[no modifications made to subsection (f)]

(g) Short-term debt limits

[no modifications made to subsection (g)]

(h) Risk committee

(1) Nonbank financial companies supervised by the Board of Governors

The Board of Governors shall require each nonbank financial company supervised by the Board of Governors that is a publicly traded company to establish a risk committee, as set forth in paragraph (3), not later than one year after the date of receipt of a notice of final determination under section 5323(e)(3) of this title with respect to such nonbank financial company supervised by the Board of Governors.

(2) Certain bank holding companies

(A) Mandatory regulations

The Board of Governors shall issue regulations requiring each bank holding company that is a publicly traded company and that has total consolidated assets of not less than ~~$10,000,000,000~~ $50,000,000,000 to establish a risk committee, as set forth in paragraph (3).

(B) Permissive regulations

The Board of Governors may require each bank holding company that is a publicly traded company and that has total consolidated assets of less than ~~$10,000,000,000~~ $50,000,000,000 to establish a risk committee, as set forth in paragraph (3), as determined necessary or appropriate by the Board of Governors to promote sound risk management practices.

(3) Risk committee

A risk committee required by this subsection shall-

(A) be responsible for the oversight of the enterprise-wide risk management practices of the nonbank financial company supervised by the Board of Governors or bank holding company described in subsection (a), as applicable;

(B) include such number of independent directors as the Board of Governors may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), as applicable; and

(C) include at least one risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.

(4) Rulemaking

The Board of Governors shall issue final rules to carry out this subsection, not later than one year after the transfer date, to take effect not later than 15 months after the transfer date.

(i) Stress tests

(1) By the Board of Governors

(A) Annual tests required

The Board of Governors, in coordination with the appropriate primary financial regulatory agencies and the Federal Insurance Office, shall conduct annual analyses in which nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) are subject to evaluation of whether such companies have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.

(B) Test parameters and consequences

The Board of Governors-

(i) shall provide for at least ~~3~~two different sets of conditions under which the evaluation required by this subsection shall be conducted, including baseline~~, adverse,~~ and severely adverse;

(ii) may require the tests described in subparagraph (A) at bank holding companies and nonbank financial companies, in addition to those for which annual tests are required under subparagraph (A);

(iii) may develop and apply such other analytic techniques as are necessary to identify, measure, and monitor risks to the financial stability of the United States;

(iv) shall require the companies described in subparagraph (A) to update their resolution plans required under subsection (d)(1), as the Board of Governors determines appropriate, based on the results of the analyses; and

(v) shall publish a summary of the results of the tests required under subparagraph (A) or clause (ii) of this subparagraph.

(2) By the company

(A) Requirement

A nonbank financial company supervised by the Board of Governors and a bank holding company described in subsection (a) shall conduct ~~semiannual~~ periodic stress tests. All other financial companies that have total consolidated assets of more than ~~$10,000,000,000~~ $250,000,000,000 and are regulated by a primary Federal financial regulatory agency shall conduct ~~annual~~ periodic stress tests. The tests required under this subparagraph shall be conducted in accordance with the regulations prescribed under subparagraph (C).

(B) Report

A company required to conduct stress tests under subparagraph (A) shall submit a report to the Board of Governors and to its primary financial regulatory agency at such time, in such form, and containing such information as the primary financial regulatory agency shall require.

(C) Regulations

Each Federal primary financial regulatory agency, in coordination with the Board of Governors and the Federal Insurance Office, shall issue consistent and comparable regulations to implement this paragraph that shall-

(i) define the term "stress test" for purposes of this paragraph;

(ii) establish methodologies for the conduct of stress tests required by this paragraph that shall provide for at least ~~3~~two different sets of conditions, including baseline~~, adverse,~~ and severely adverse;

(iii) establish the form and content of the report required by subparagraph (B); and

(iv) require companies subject to this paragraph to publish a summary of the results of the required stress tests.

(j) Leverage limitation

(1) Requirement

The Board of Governors shall require a bank holding company with total consolidated assets equal to or greater than ~~$50,000,000,000~~ $250,000,000,000 or a nonbank financial company supervised by the Board of Governors to maintain a debt to equity ratio of no more than 15-to-1, upon a determination by the Council that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States. Nothing in this paragraph shall apply to a Federal home loan bank.

(2) Considerations

In making a determination under this subsection, the Council shall consider the factors described in subsections (a) and (b) of section 5323 of this title and any other risk-related factors that the Council deems appropriate.

(3) Regulations

The Board of Governors shall promulgate regulations to establish procedures and timelines for complying with the requirements of this subsection.

(k) Inclusion of off-balance-sheet activities in computing capital requirements

[no modifications made to subsection (k)]