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Financial Services Regulatory Reform Legislation

Senate Approves Bipartisan Regulatory Reform Bill

SUMMARY

Last Wednesday, the United States Senate approved, by a vote of 67 to 31, the "Economic Growth, Regulatory Relief, and Consumer Protection Act" (the "Senate Bill"),[1] which includes certain limited amendments to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and other targeted modifications to various post-crisis regulatory requirements. In addition, the Senate Bill would establish new consumer protections and amend various securities- and investment company-related requirements. Although this bipartisan legislation sponsored by Senate Banking Committee Chairman Mike Crapo (R-ID) would preserve the foundations of the post-Dodd-Frank regulatory framework, it includes some significant modifications and, if enacted, would result in meaningful regulatory relief, in particular, for smaller and certain regional banking organizations.

Notable provisions of the Senate Bill include:

- an increase, from $50 billion to $250 billion, in the Dodd-Frank asset threshold for enhanced prudential supervision (often referred to as "SIFI" designation) of bank holding companies ("BHCs");
- an exemption from the Volcker Rule for insured depository institutions with less than $10 billion in consolidated assets and low levels of trading assets and liabilities that are not controlled by a company that itself exceeds these thresholds;
- modifications to the banking agencies' Liquidity Coverage Ratio ("LCR") relating to the treatment of certain municipal securities;
- modifications to the banking agencies' Supplementary Leverage Ratio ("SLR") requirements as applied to "custodial banks";
- 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;
- protections for student loan borrowers in situations involving the death of the borrower or cosigner and those seeking to "rehabilitate" their student loans;
- an increase in the limit on 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 cybersecurity threats, algorithmic trading, and Puerto Rico's housing market.

The legislation now moves to the House of Representatives, where its consideration could take several different procedural paths. If passed by the House without further amendment, the bill would go directly to the President for his signature. Although the Senate Bill contains numerous provisions that were previously considered in the House, Rep. Jeb Hensarling (R-TX), Chairman of the House Financial Services Committee, has indicated that he will seek to further amend the Senate Bill by including additional financial services bills that have passed the House with substantial bipartisan support.[2] President Trump said he "looks forward to discussing any further revisions the House is interested in making, with the goal of bipartisan, pro-growth Dodd-Frank relief reaching his desk as soon as possible."[3]

BACKGROUND

A. SENATE CONSIDERATION

As discussed in our previous Memorandum to Clients, in January of last year, Chairman Crapo announced that he would seek common ground with Banking Committee Democrats on a regulatory reform bill that he hoped to advance in a "strong, bipartisan manner."[4] The Senate Bill, which has 12 Democratic, one Independent, and 12 Republican cosponsors,[5] is the result of those discussions.

As described below, the Senate Bill is largely similar to the version approved by the Senate Banking Committee on December 5, 2017,[6] but includes a number of modifications that resulted from the Senate floor debate. These include provisions related to, among other matters, student loans, securities exchanges, and registered and exempt investment companies. Several of these modifications, as well as many provisions in the underlying bill as originally introduced, mirror bills approved by the House in 2017 and 2018, that were also approved with substantial bipartisan support.

B. DODD-FRANK ENHANCED PRUDENTIAL STANDARDS

The Senate Bill includes a variety of proposals to modify post-crisis regulatory requirements that apply to banking organizations of all sizes, although the most substantial of these modifications would be reserved for smaller, midsize, and certain regional banks. Most notably, the legislation would raise the statutory asset threshold that requires the Federal Reserve to apply the "enhanced prudential standards" ("EPS") set forth in Section 165 of Dodd-Frank.[7] Currently, almost the entire suite of EPS applies to BHCs with $50 billion or more in total consolidated assets.[8] These 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.

1. SIFI Threshold

Section 401 of the Senate Bill would raise the $50 billion "SIFI threshold" to $250 billion, but stagger the application of this change based on the size of the covered BHC. BHCs with $250 billion or more in total consolidated assets would remain subject to the full suite of EPS, and Section 401(f) of the Senate Bill provides that any domestic BHC identified as a global systemically important BHC ("G-SIB") for purposes of the Federal Reserve's risk-based capital surcharge would also remain subject to the full suite of EPS, regardless of its total asset size.[9]

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

BHCs with total consolidated assets of $100 billion or more but less than $250 billion would no longer be subject to Section 165 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 would also retain the discretionary authority to apply any enhanced prudential standard to any BHC or BHCs with between $100 billion and $250 billion in total consolidated assets that would otherwise have been exempt under the legislation. To do so, however, it would have to (i) act by order or rule promulgated pursuant to Section 553 of the Administrative Procedure Act (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."

At a recent House Financial Services Committee hearing, Federal Reserve Board Chairman Jay Powell expressed his support for these provisions, including the increase in the SIFI threshold and the 18-month off-ramp, arguing that banks with less than $250 billion in assets are "generally" engaged in the traditional business of banking and that, by providing the Federal Reserve with authority to apply EPS to BHCs with between $100 and $250 billion in assets, the legislation "gives [the Federal Reserve] the tools [it] needs."[10]

2. Company-Run Stress Tests

Section 401 would exempt all BHCs, banks, savings and loan holding companies, and savings associations with less than $250 billion in total consolidated assets from the Dodd-Frank requirement to conduct company-run stress tests.[11] Institutions with $250 billion or more in total consolidated assets would still be required to conduct these company-run stress tests, but would be permitted to do so on a "periodic" basis, rather than semiannually for BHCs and annually for other institutions, as currently required, and would eliminate the adverse scenario as a required 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 Federal Reserve would continue to conduct annual supervisory stress tests for BHCs with $250 billion or more in total consolidated assets, but, as for the company-run stress tests, the legislation would eliminate the adverse scenario as a required scenario, reducing the minimum number of supervisory scenarios from three (baseline, adverse, and severely adverse) to two (baseline and severely adverse). Although Section 401 would eliminate the annual Dodd-Frank supervisory stress testing requirement for BHCs with less than $250 billion in assets, the Federal Reserve would still be 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 would no longer be subject to statutorily mandated supervisory stress tests.

4. Risk Committees and Credit Risk Exposure Reports

Section 401 would modify the trigger point for the requirement that a publicly-traded BHC establish a risk committee from $10 billion to $50 billion or more in total consolidated assets.[12] In addition, the legislation would amend Dodd-Frank's requirement that covered BHCs and nonbank SIFIs submit credit exposure reports. Section 401 would permit, but not mandate, 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

Section 401 would require the Federal Reserve, in exercising its discretionary authority to apply elements of the EPS framework to BHCs of any size, to tailor their application based on certain factors. These factors include capital structure, riskiness, complexity, financial activities, and size. The tailoring can be applied either individually or categorically. Dodd-Frank currently permits—but does not require—such tailoring. In addition, the Senate Bill 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.

6. Other Dodd-Frank Thresholds

In conjunction with raising the asset thresholds in Section 165, the Senate Bill would raise 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 Senate Bill would also amend the prior notice requirements 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, the Senate Bill 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]."[13]

The Senate Bill would also increase, from $50 billion to $100 billion, the thresholds for assessments, fees, and other charges collected by the Federal Reserve from BHCs, nonbank SIFIs, and savings and loan holding companies to fund its supervisory and regulatory responsibilities. In addition, the legislation would require tailoring of these assessments, fees, and charges for BHCs, nonbank SIFIs, and savings and loan holding companies with between $100 billion and $250 billion in total consolidated assets.[14]

The following chart summarizes the existing application of EPS to BHCs, as modified by the Senate Bill:

Senate Bill – Application of EPS to BHCs				
	Current (≥$50B)	Senate Bill (≥$250B & G-SIBs)	Senate Bill ($100B–$250B)†	Senate Bill (<$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	✓	✓	✗	✗

† Subject to Federal Reserve application of EPS during the 18-month off-ramp.

‡ 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.

7. Applicability to Foreign Banking Organizations

Foreign companies with U.S. banking operations, known as "foreign banking organizations" ("FBOs"), are treated as BHCs for purposes of Section 165 of Dodd-Frank,[15] and, therefore, the increase in the asset thresholds for BHCs would also apply to the application of EPS to FBOs. Currently, an FBO with U.S. non-branch assets of $50 billion or more must establish an intermediate holding company ("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.[16]

The versions of the bill as originally introduced and passed by the Senate Banking Committee were silent on the treatment of FBOs under Section 401. 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.[17] The legislation does not direct the Federal Reserve to review or change its current use of multiple asset calculations in applying EPS to FBOs and their U.S. operations—global (rather than U.S.) consolidated assets, combined U.S. assets and U.S. non-branch assets—in its layered application of EPS to FBOs under Regulation YY, nor does it direct the Federal Reserve to retain or revise the asset threshold for the IHC requirement.

8. Non-Dodd-Frank Requirements

As described above, the Senate Bill addresses the application of the Dodd-Frank EPS, but it would not automatically affect or modify other post-crisis regulatory requirements that use a $50 billion asset threshold but were established under other legal authorities. Of most significance, the Senate Bill does not address the applicability of the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") process to BHCs with total consolidated assets of $50 billion or more and IHCs of FBOs.[18] If the Senate Bill were enacted, however, it is expected that the Federal Reserve would revise its CCAR process in a manner consistent with the legislation's modification of the Section 165 standards.

C. OTHER BANK CAPITAL AND LIQUIDITY REFORMS

In addition to modifying the EPS, the Senate Bill would make certain changes to bank capital and liquidity requirements:

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

Section 402 would require the Federal banking agencies to amend their rules implementing the SLR, which became effective on January 1, 2018,[19] to specify that funds of a "custodial bank"[20] 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 only apply to a small number of banking organizations.

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

Section 403 would direct the Federal banking agencies to amend their LCR rules[21] 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.[22] The Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation 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,[23] instead of the 100 percent risk-weight that would otherwise typically apply if the exposures were not classified as HVCRE exposures. Section 214 would statutorily prescribe that the Federal banking agencies may only require depository institutions to apply a heightened risk weight to HVCRE exposures if the exposures meet the narrower definition of "HVCRE ADC loan" set forth in that section. Of note, the definition of HVCRE ADCE loan excludes loans made prior to January 1, 2015 (the effective date of the standardized approach) and revises the 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.[24] The legislation clarifies, however, that nothing in Section 214 "shall limit the supervisory, regulatory, or enforcement authority of the appropriate Federal banking agency to further the safe and sound operation of an institution under the supervision of the appropriate Federal banking agency."

D. ADDITIONAL POST-CRISIS REFORMS

The Senate Bill 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 would exempt a banking entity 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 would amend 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.*, FBOs) and (2) the name does not contain the word "bank."

3. Capital Requirements for Smaller Institutions

Section 201 would require the Federal banking agencies to promulgate a rule establishing a new "Community Bank Leverage Ratio" of 8-10% for banks and BHCs with less than $10 billion in total consolidated assets. If such a bank or BHC 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 bank, 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 bank or BHC 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 would be 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.

E. SMALL BANK REGULATORY RELIEF

In addition to the provisions above, the Senate Bill would revise 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 would automatically be 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 no appraisal is 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 would require 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[25] to apply to certain BHCs and savings and loan holding companies with pro forma consolidated assets of less than $3 billion—an increase from the current $1 billion threshold. The Federal Reserve would retain the authority to exclude any BHC or savings and loan holding company from the policy if such action is warranted for supervisory purposes. In addition, Section 210 would increase 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 would require 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 would permit 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 would be 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 of similar House-passed language, these provisions are designed 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.[26]

F. INTERNATIONAL INSURANCE STANDARDS

Section 211 would require 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 would be required to submit a report to and testify before Congress within 180 days of the date of enactment of the Senate Bill 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 would also require 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, would be 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 would establish 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."

G. ADDITIONAL BANKING PROVISIONS

The Senate Bill also contains the following banking-related provisions:

1. Increase in HMDA Reporting Thresholds

Section 104 would exempt insured institutions from being subject to 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.[27] 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 would authorize 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 produce or service. Except as required to comply with Federal anti-money laundering requirements, the institution could 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 Senate Bill explicitly preempts and supersedes any conflicting State law, but only to the extent of such

conflict. The 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,[28] Section 217 would decrease the size of the Federal Reserve Banks' combined surplus fund from $7.5 billion to $6.825 billion. The surplus fund was decreased earlier this year from $10 billion to $7.5 billion as part of the Bipartisan Budget Act of 2018.[29]

4. Report on Puerto Rico's Housing Market

Section 311 would direct 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.

H. CONSUMER PROTECTIONS

In addition to numerous banking regulatory reforms, the Senate Bill 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

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

In addition, Section 308 would require 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 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 would mandate that Fannie Mae and Freddie Mac 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 would require 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, the bill stops short of directing any specific government action to address this pressing issue.

3. Senior Citizen Financial Exploitation Reporting Immunity

Section 303 would provide 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 would amend 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 would not be retroactive and would 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.

I. SECURITIES-RELATED REFORMS

The Senate Bill 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 would amend 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 would require the Securities and Exchange Commission ("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 would amend 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 100 beneficial owners for all other types of companies. The Senate Bill defines "qualifying venture capital fund" as a venture capital fund[30] with aggregate capital contributions and uncalled committed capital not exceeding $10,000,000.[31] 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 would require 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 would eliminate a long-standing exemption from registration under the 1940 Act 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 would be 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 would direct 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 would direct 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 of 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 would require 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 would be 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 would be deemed to be eligible issuers under the SEC's regulations.[32] The Senate Bill 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.[33]

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ENDNOTES

[1] *See* S. 2155, 115th Cong. (2018), *available at* https://www.congress.gov/115/bills/s2155/BILLS-115s2155es.pdf.

[2] *See* U.S. House Committee on Financial Services, *Hensarling Congratulates Senate, Calls for Continued Negotiation* (Mar. 14, 2018), *available at* https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=403221.

[3] *See* White House, *Statement from the Press Secretary on the Passage of S.2155* (Mar. 14, 2018), *available at* https://www.whitehouse.gov/briefings-statements/statement-press-secretary-passage-s-2155/.

[4] *See* U.S. Senate Committee on Banking, Housing, & Urban Affairs, *Crapo Statement at Nomination Hearing* (Jan. 12, 2017), *available at* https://www.banking.senate.gov/public/index.cfm/2017/1/crapo-statement-at-nomination-hearing.

[5] List of co-sponsors available at https://www.congress.gov/bill/115th-congress/senate-bill/2155/cosponsors?q=%7B%22search%22%3A%5B%22s2155%22%5D%7D&r=1.

[6] For a summary of the previous versions of the Senate Bill, see our Client Memorandum, *Financial Services Regulatory Reform Legislation: Senators Introduce Bipartisan Regulatory Reform Bill*, dated November 20, 2017, *available at* https://sullcrom.com/financial-services-regulatory-reform-legislation-senators-introduce-bipartisan-regulatory-reform-bill, and our Client Memorandum, *Financial Services Regulatory Reform Legislation: Senate Panel Approves Bipartisan Regulatory Reform Bill*, dated December 7, 2017, *available at* https://www.sullcrom.com/financial-services-regulatory-reform-legislation-senate-panel-approves-bipartisan-regulatory-reform-bill.

[7] *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations Final Rule, 79 Fed. Reg. 17,239 (Mar. 27, 2014), *available at* https://www.gpo.gov/fdsys/pkg/FR-2014-03-27/pdf/2014-05699.pdf.

[8] The regulations implementing these standards use the 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.

[9] *See* 12 C.F.R. § 217.402.

[10] *Monetary Policy and the State of the Economy: Hearing Before the House Fin. Servs. Comm.*, 115th Cong. (Feb. 27, 2018), *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403088.

[11] *See* 12 C.F.R. §§ 46.5, 252.14, 252.54, 252.55 and 325.204 (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).

ENDNOTES (CONTINUED)

[12] *See* 12 C.F.R. § 252.22. Similarly, the Federal Reserve could, but would not be 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 currently has with respect to publicly-traded BHCs with total consolidated assets of less than $10 billion.

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

[14] The legislation would require 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 [Senate Bill] with respect to each such [institution]."

[15] *See* 12 U.S.C. § 5311(a)(1).

[16] *See* 12 C.F.R. § 252.153(a).

[17] The Federal Reserve has adopted a global asset test for application of the enhanced prudential standards under Regulation YY to FBOs, although certain requirements, such as the IHC requirement, are also based on various measures of U.S. assets. Nearly all FBOs with significant U.S. operations (including those subject to the IHC requirement) exceed $100 billion in total global assets.

[18] The Federal Reserve conducts CCAR pursuant to the capital plan rule, which is codified as Section 225.8 of the Federal Reserve's Regulation Y. Section 165 of Dodd-Frank is not among the authorities for Regulation Y. *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.

[19] 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.

[20] The bill 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."

[21] 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.

[22] *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*

ENDNOTES (CONTINUED)

Purposes of the Liquidity Coverage Ratio, dated April 5, 2016, *available at* https://www.sullcrom.com/bank-liquidity-requirements-04-05-2016.

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

24 In September 2017, the Federal banking agencies proposed a rule that would, among other things, revise the treatment of HVCRE exposures under the standardized approach. That proposed rule would eliminate the exemption for loans with substantial borrower-contributed capital. 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.

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

26 *See* H.R. Rep. No. 115-530, at 2 (2017) (House committee report on the "Federal Savings Association Charter Flexibility Act of 2017," a similar bill that was passed by the House as part of Rep. Hensarling's Financial CHOICE Act of 2017).

27 12 C.F.R. § 1003.2(g)(1)(v) (effective Jan. 1, 2018); 82 Fed. Reg. 43088 (Sept. 13, 2017).

28 *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.

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

30 The Senate Bill 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.

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

32 *See* Securities Offering Reform Final Rule, 70 Fed. Reg. 44,722 (Aug. 3, 2005).

33 *See* 17 C.F.R. § 230.482.

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