Simpson Thacher

Memorandum

Senate Rolls Back Key Provisions of Dodd-Frank

March 16, 2018

On March 14, 2018, the U.S. Senate passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155), a financial reform bill also known as the "Crapo Bill" for its primary sponsor, Senator Mike Crapo (R-ID). Although not as sweeping in scope as the Financial CHOICE Act—the financial reform bill passed by the House of Representatives in June 2017—the Crapo Bill would make targeted changes to several major provisions of the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The Crapo Bill is primarily focused on providing regulatory relief for smaller banks, including an exemption from the Volcker Rule for smaller banks with limited trading operations, and "off-ramp" relief from capital and leverage requirements as well as an exemption from "qualifying mortgage" rules for certain banking organizations with under $10 billion in total assets. For the larger banking organizations, the Crapo Bill would increase the asset threshold for a bank holding company to be considered a "systemically important financial institution" ("SIFI")—and therefore subject to certain enhanced prudential regulation by the Federal Reserve—from $50 billion to $250 billion.

The Crapo Bill has earned bipartisan support, with 16 Democratic senators and one Independent senator voting in favor of the bill. In light of this bipartisan support in the Senate, it is expected that any financial reform legislation ultimately passed by both chambers of Congress will more closely resemble the Crapo Bill than the Financial CHOICE Act. Following is a high-level summary of certain key features of the Crapo Bill.

Volcker Rule

While the Financial CHOICE Act passed by the House of Representatives would repeal the Volcker Rule in its entirety, the Crapo Bill provides more limited relief. In particular, the Crapo Bill would exempt banking entities from the Volcker Rule if they have (and are not controlled by a company that has) (1) less than $10 billion in total consolidated assets and (2) total trading assets and trading liabilities that are not more than 5% of total consolidated assets.

In addition, with regard to the so-called sponsored funds or asset management exemption of the Volcker Rule, the Crapo Bill would modify the prohibition on banking entities sharing the same name or a variation of the same name with a covered fund for corporate, marketing, promotional, or other purposes. Instead, covered funds may share the same name or a variation of the same name as a banking entity that is an investment adviser to such fund as long as such name does not contain the word "bank" and the investment adviser is not itself (and does not share the same 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 otherwise treated as a bank holding company.

Increased SIFI Threshold

Significantly, the Crapo Bill would raise the total asset threshold for bank holding companies to qualify as SIFIs subject to enhanced prudential standards from $50 billion to $250 billion. Bank holding companies with total consolidated assets of between $50 billion and $100 billion would be exempt from the Federal Reserve's enhanced prudential standards immediately, while bank holding companies with total consolidated assets of between $100 billion and $250 billion would be exempt from such standards 18 months after the date of the bill's enactment (although the Federal Reserve would be able to exempt such firms from enhanced prudential standards prior to the conclusion of the 18-month period on a case-by-case basis). The Federal Reserve would also retain the authority to apply enhanced prudential standards to bank holding companies with total assets between $100 billion and $250 billion on a case-by-case basis.

The Crapo Bill does not affect the Federal Reserve's enhanced prudential standards as applied to foreign banking organizations ("FBOs") with total consolidated assets of at least $100 billion, including the Federal Reserve's authority to require that such an FBO establish a U.S. intermediate holding company if it has at least $50 billion in U.S. non-branch assets (which was not required by Dodd-Frank). This will create a dichotomy where FBOs with more than $50 billion in U.S. non-branch assets will remain subject to the Federal Reserve's enhanced prudential standards for their U.S. operations, while a comparably sized U.S. bank holding company with less than $250 billion in total assets generally will not. Although the Crapo Bill provides some regulatory relief for FBOs with less than $100 billion in total consolidated assets, most such FBOs are not currently subject to the more stringent provisions of the Federal Reserve's enhanced prudential standards.

It should be noted that the Crapo Bill's increase in the SIFI asset threshold would not automatically eliminate the $50 billion threshold used elsewhere in regulations and guidance issued by the federal banking agencies (such as in the Office of the Comptroller of the Currency's "heightened standards"). We expect a statutory change to the SIFI asset threshold would encourage the federal banking agencies to revisit the $50 billion threshold used in other regulatory contexts.

Stress Testing

Under the Crapo Bill, bank holding companies with total consolidated assets of between $10 billion and $250 billion would no longer be required to conduct company-run stress tests. Bank holding companies with more than $250 billion in assets (or more than $100 billion in assets that the Federal Reserve has deemed subject to enhanced prudential standards) and nonbank SIFIs would be required to conduct company-run stress tests on a "periodic," rather than annual or semi-annual, basis. Because the bill does not specify any minimum frequency for the company-run stress testing requirement, the Federal Reserve would have discretion in setting the maximum intervals between company-run stress tests.

The Federal Reserve would be required to conduct tests, on a periodic basis, for bank holding companies with total consolidated assets of $100 billion or more and less than $250 billion. However, bank holding companies with $250 billion or more in total consolidated assets and nonbank SIFIs would continue to be subject to annual Federal Reserve-run stress tests. Bank holding companies with total consolidated assets of less than $100 billion would not be subject to these stress tests.

For both company-run and Federal Reserve-run stress tests, the Crapo Bill would reduce the number of required test scenarios from three to two (baseline and "severely adverse"), eliminating the "adverse" scenario.

"Off-Ramp" Relief for Qualifying Community Banks

One of the most notable aspects of the Financial CHOICE Act is its regulatory "off-ramp" feature, allowing a qualifying banking organization of any size to elect to be exempt from a wide variety of risk-weighted capital requirements, liquidity requirements and a variety of other regulations if the organization maintains an average non-risk weighted leverage ratio of at least 10%. The Crapo Bill adopts a similar, but more limited, feature, allowing a qualifying community bank with less than $10 billion in total assets to be exempt from generally applicable capital and leverage requirements if the bank complies with a leverage ratio between 8-10% (to be determined by the federal banking agencies).

The Crapo Bill's off-ramp provision would provide relief for qualifying banks only with respect to the minimum capital and leverage ratios otherwise applicable under prompt corrective action standards. Unlike the Financial CHOICE Act, it would not relieve qualifying banks from other regulatory requirements, such as enhanced liquidity standards, resolution planning, and stress testing requirements.

Other Key Bank Regulatory Reforms

- **Small Bank Holding Company Policy Statement**. The Crapo Bill would require the Federal Reserve to increase the asset threshold for application of its Small Bank Holding Company Policy Statement from $1 billion to $3 billion, thereby permitting a greater number of community banking institutions to finance the acquisition of banks or other companies with debt levels higher than would be permitted for larger holding companies.
- **Federal Savings Association Charter Flexibility**. The Crapo Bill would allow federal savings associations with $20 billion or less in total assets to elect, upon 60 days' prior notice to the OCC, to be subject to the same rights, privileges, duties and restrictions as a national bank. This would exempt electing federal savings associations from, among other things, certain asset-based limitations such as those applicable to commercial and consumer loans, unsecured construction loans, and non-residential real property loans.
- **Supervisory Ratio Calculations**. The Crapo Bill would adjust the calculation of certain supervisory ratios, including the supplementary leverage ratio and liquidity coverage ratio. In particular, the bill specifies that a custodial bank may exclude funds deposited with a central bank from the custodial bank's total assets for purposes of calculating the custodial bank's supplementary leverage ratio (thus eliminating the need for custodial banks to set aside capital for funds held at central banks). The Crapo Bill also permits all banks to include certain investment-grade municipal securities as "level 2B" liquid assets for purposes of calculating the bank's the liquidity coverage ratio.
- **Real Estate Lending Relief**. The Crapo Bill provides a qualified mortgage safe harbor from Truth in Lending Act requirements for mortgage loans that are originated and retained in portfolio by an insured depository institution with less than $10 billion in total assets. The qualified mortgage safe harbor is generally not available for mortgage loans that a bank sells on the secondary market. The Crapo Bill also limits the ability of federal banking agencies to assign a heightened risk weighting to high volatility commercial real estate assets other than acquisition, development and construction loans, while also clarifying the scope of loans considered to be commercial real estate acquisition, development or construction loans.

Prospects for Enactment

The Crapo Bill was approved by the Senate by a vote of 67 to 31, with 16 Democratic senators and one independent senator voting in favor of the bill. The bill is expected to be voted on by the House of Representatives in the coming months. Given the significant differences between the Crapo Bill and the Financial CHOICE Act, it is unlikely that the House of Representatives will pass the Crapo Bill without any modification. House Financial Services Committee Chairman Jeb Hensarling, the sponsor of the Financial CHOICE Act, has expressed a desire to include more significant regulatory relief provisions in the ultimate legislation. However, any legislation ultimately passed by both chambers of Congress would likely closely resemble the Crapo Bill in order to maintain the delicate balance of bipartisan support that the bill has earned in the Senate.

For further information about this decision, please contact one of the following members of the Firm's Financial Institutions Group.

FINANCIAL INSTITUTIONS

Lee A. Meyerson
+1-212-455-3675
lmeyerson@stblaw.com

Keith A. Noreika
+1-202-636-5864
keith.noreika@stblaw.com

Mark Chorazak
+1-212-455-7613
mchorazak@stblaw.com

Spencer A. Sloan
+1-212-455-7821
spencer.sloan@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000