Memorandum

President Trump Signs Financial Reform Legislation to Roll Back Key Provisions of Dodd-Frank

May 29, 2018

On May 24, 2018, President Trump signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Reform Act"), the most significant financial reform legislation since the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Although not as sweeping in scope as other reform proposals recently considered in Congress, the Reform Act makes targeted changes to several major provisions of the Dodd-Frank Act. The Reform Act 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 larger banking organizations, the Reform Act increases 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 Reform Act earned bipartisan support, with 16 Democrats and one independent voting in favor of the bill in the Senate, and 33 Democrats voting in favor of the bill in the House of Representatives. Largely to hold the bipartisan support in the Senate, the House passed the bill on May 22 in identical form to the bill passed by the Senate on March 14. However, Republican leaders from both chambers of Congress have indicated that further financial reform efforts may be forthcoming later this year.

Following is a high-level summary of certain key features of the Reform Act.

Volcker Rule

The Reform Act provides the banking industry limited relief from the Volcker Rule, exempting banking entities from the Volcker Rule if they (including any company that controls them) have (1) less than $10

billion in total consolidated assets or (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 Reform Act modifies 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 Reform Act raises 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 will 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 will be exempt from such standards after November 2019 (18 months after the Reform Act's enactment). The Federal Reserve will be able to exempt firms with total assets between $100 billion and $250 billion from enhanced prudential standards prior to the conclusion of the 18-month period on a case-by-case basis. The Federal Reserve will also retain the authority to apply enhanced prudential standards, even after November 2019, to bank holding companies with total assets between $100 billion and $250 billion on a case-by-case basis. In addition, the Reform Act applies enhanced prudential standards to any institution identified as a global systemically important bank holding company ("GSIB") as if the GSIB has $250 billion or more in total consolidated assets, regardless of the GSIB's actual asset size.

The Reform Act 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 (up to $250 billion in total assets) generally will not. Although the Reform Act 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 Reform Act's increase in the SIFI asset threshold will 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 that the Reform Act's statutory change to the SIFI asset threshold will encourage the federal banking agencies to revisit the $50 billion threshold used in other regulatory contexts.

Stress Testing and CCAR

Under the Reform Act, banks, bank holding companies, thrifts and thrift holding companies with total consolidated assets of between $10 billion and $250 billion will no longer be required to conduct company-run stress tests. Any such institution with more than $250 billion in assets (or a bank holding company with more than $100 billion in assets that the Federal Reserve has deemed subject to enhanced prudential standards) and nonbank SIFIs will be required to conduct company-run stress tests on a "periodic," rather than annual or semi-annual, basis. Because the Reform Act does not specify any minimum frequency for the company-run stress testing requirement, the federal banking agencies will have discretion in setting the maximum intervals between company-run stress tests.[1]

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

For both company-run and Federal Reserve-run stress tests, the Reform Act reduces the number of required test scenarios from three to two (baseline and "severely adverse"), eliminating the "adverse" scenario. In addition, the Reform Act applies both company-run and supervisory stress tests to any institution identified as a GSIB as if the GSIB has $250 billion or more in total consolidated assets, regardless of the GSIB's actual asset size.

Because the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") process is not conducted under the Dodd-Frank Act's stress testing provisions or pursuant to the Dodd-Frank Act's "enhanced prudential standards" authority, the Reform Act's stress testing and SIFI threshold amendments do not directly impact the applicability of the CCAR process to the institutions currently subject to CCAR

[1] All amendments to the Dodd-Frank Act made by Section 401 of the Reform Act, including the changes to the Dodd-Frank Act stress testing requirements, generally take effect 18 months from the date of enactment, but are effective immediately "with respect to any bank holding company" that has less than $100 billion in total consolidated assets. On the face of the statute, this immediate effectiveness is not applicable for amendments with respect to other regulated financial institutions (such as banks, thrifts and thrift holding companies), even those with less than $100 billion in assets. Accordingly, the Reform Act's relief from company-run stress testing for such non-bank holding company institutions, regardless of asset size, may not take effect until November 2019.

(*i.e.*, bank holding companies with total consolidated assets of $50 billion or more, intermediate holding companies of FBOs with at least $50 billion in U.S. non-branch assets, and nonbank SIFIs). The Federal Reserve's assessment of a CCAR company's capital plan relies, in part, on the results of stress tests conducted by the company or the Federal Reserve, such that the continued annual application of CCAR to bank holding companies with less than $250 billion in total assets would frustrate the Reform Act's clear legislative intent of exempting such institutions from annual stress testing requirements. Accordingly, the Federal Reserve would be expected to revisit its capital plan rule to align the application of CCAR with the application of enhanced prudential standards and/or statutory stress testing requirements.

"Off-Ramp" Relief for Qualifying Community Banks

The Reform Act adopts a limited regulatory "off-ramp" 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% and 10% (to be determined by the federal banking agencies).

The Reform Act's off-ramp provision provides relief for qualifying banks only with respect to the minimum capital and leverage ratios otherwise applicable under prompt corrective action standards. It does 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 Reform Act requires 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 Reform Act allows 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. Such an election will exempt a federal savings association 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 Reform Act adjusts the calculation of certain supervisory ratios, including the supplementary leverage ratio and liquidity coverage ratio. In particular, the Reform Act 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 Reform Act 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 Reform Act 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 Reform Act 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.

Potential Future Reform Efforts

The Reform Act is significantly more limited in scope than the Financial CHOICE Act, the financial reform bill passed by the House of Representatives in June 2017 which would have repealed the Volcker Rule in its entirety, restructured the Bureau of Consumer Financial Protection and provided a regulatory "off-ramp" feature for qualifying banking organizations of any size to elect to be exempt from a wide variety of risk-weighted capital requirements, liquidity standards and a variety of other regulations. House Financial Services Committee Chairman Jeb Hensarling, the primary sponsor of the Financial CHOICE Act, has indicated that he is preparing to push additional reform bills through Congress, calling the Reform Act a "great floor" while still wanting "to work on the ceiling." Prior to House passage of the Reform Act, Rep. Hensarling identified a number of bills that have been passed by the House and that he wished to see negotiated with the Senate, including the following:

- The Financial Institution Living Will Improvement Act, which would amend the Dodd-Frank Act to make the "living will" review period every two years, rather than periodically, and require the federal banking regulators to provide feedback on living wills to firms within six months after submission. The bill would also require the federal banking regulators to publicly disclose their living will assessment framework. The bill passed the House by a vote of 414-0 in January 2018.
- The Financial Institutions Examination Fairness and Reform Act, which would reform the regulatory examination process for financial institutions by setting timelines for review, feedback on examinations, and an appeals procedure. The bill passed the House in March 2018 on a 283-133 vote.
- The Taking Account of Institutions with Low Operation Risk (TAILOR) Act, which would require financial regulatory agencies to tailor regulatory actions to limit the burdens on affected institutions in consideration of their risk profiles. The bill passed the House in March 2018 on a 247-169 vote.
- The Bureau of Consumer Financial Protection Examination and Reporting Threshold Act, which would raise the asset size threshold for subjecting financial institutions to CFPB reporting

requirements and direct examinations from $10 billion to $50 billion. The bill was passed out of the House Financial Services Committee on a 39-21 vote.

These bills, along with a number of other bills in the capital formation space, could form the basis of any additional near-term financial reform legislation. Although the prospects for such further reform remain uncertain, Senate Majority Leader Mitch McConnell has stated that Senate Republicans “look forward to an additional reform package coming together that can pass the House and Senate this year.”

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