

Bank Regulatory Relief To Become Law, Focus Shifts to Agencies

May 22, 2018

Earlier today, the U.S. House of Representatives passed the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Bill”). The Bill would provide regulatory relief for a range of banking organizations, primarily, but not exclusively, focused on \$250 billion asset and smaller firms. Identical legislation passed the U.S. Senate on March 14, 2018. President Donald J. Trump is expected to sign the Bill into law in the near future.

**Debevoise
& Plimpton**

The Bill removes bank holding companies (“BHCs”) with less than \$100 billion in assets from the application of enhanced prudential standards upon enactment, eliminates after no later than eighteen months the applicability of enhanced prudential standards to BHCs with between \$100 billion and \$250 billion in assets unless the Federal Reserve Board (the “FRB”) takes affirmative action to retain enhanced prudential standards for such institutions, and effectively maintains the status quo for U.S. global systemically important BHCs (“GSIBs”) and BHCs with more than \$250 billion of assets. The Bill does not change the use of global assets for determining whether a foreign banking organization (“FBO”) is subject to the enhanced prudential standards in section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), nor does it revise the requirement for certain FBOs to structure their U.S. operations under a U.S. intermediate holding company (which itself is subject to enhanced prudential standards). Redlines showing changes to existing statutes and other key provisions of the Bill are available on our website [here](#).

The Bill is an important step forward in reevaluating the post-crisis regulatory framework and creating tailored supervision and regulation for BHCs. The relief it provides, however, is limited in scope, focused mostly on Dodd-Frank Act section 165. The various regulatory agencies will need to undertake a broad review of their regulations and guidance that use the \$50 billion asset threshold. Indeed, it would seem revising the threshold everywhere it is used would be merited in light of the Bill’s passage.

For example, the Bill underscores the need for FRB action to recalibrate the \$50 billion asset threshold that triggers the FRB’s capital plan rule and Comprehensive Capital

Analysis and Review program (“CCAR”). Although the issue is not completely clear, we also believe the modified liquidity coverage ratio (“LCR”) may require separate FRB action to raise its current applicability threshold of \$50 billion in assets. Without such further action, the bottom line benefit of the Bill would not be as great. We previously predicted that this legislation would have momentum in Washington (see our prior client update [here](#)). We now predict that the Bill will usher in a wave of broader regulatory and supervisory changes, led by the FRB, but also by the other financial regulatory agencies. Thus, while the Bill represents significant change, there remains a need for a broader review of other post-crisis regulatory requirements that use the \$50 billion asset threshold.

The Bill covers a wide range of topics. This Debevoise In Depth focuses on the provisions regarding enhanced prudential standards, how the Bill reduces regulatory requirements for community banks, discrete aspects of the Volcker Rule that are changed, and studies the Treasury Department and Securities and Exchange Commission (the “SEC”) are required to prepare on cyber risks and algorithmic trading, respectively. We provide a summary of how the Bill changes the asset thresholds for key regulatory requirements in [Appendix A](#).

Revising the Dodd-Frank Act's \$50 Billion Asset Threshold

The Bill raises the \$50 billion asset threshold that the Dodd-Frank Act uses for application of enhanced prudential standards as follows:

- **Less Than \$100 Billion.** Effective immediately on the Bill's enactment, BHCs with total consolidated assets of less than \$100 billion are no longer subject to enhanced prudential standards.
- **\$100 to \$250 Billion.** Within 18 months after the Bill's enactment, BHCs with between \$100 billion and \$250 billion in total consolidated assets are subject to the following revised framework.

Stress Testing. The FRB is required to undertake periodic supervisory stress tests of BHCs in this category “to evaluate whether such [BHCs] have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.” Importantly, this authority applies to BHCs as defined under the Bank Holding Company Act (“BHC Act”), effectively meaning that foreign banks without an insured bank subsidiary do not fall within the scope of this provision. The reason for this result is that the provision mandating such stress tests is not incorporated into section 165 of the Dodd-Frank Act, which uses a broader definition of the term BHC that picks up

foreign companies with any U.S. banking presence. Instead, the BHC Act's narrower definition of BHC would apply for this purpose.

Discretionary Measures. The FRB retains discretion to apply enhanced prudential standards to any BHC (or category of BHCs) in this category, taking into account risk-related factors such as the BHC's capital structure, riskiness, complexity, financial activities, and size. To use this discretionary authority, the FRB needs to determine that application is appropriate to mitigate risks to U.S. financial stability or to promote safety and soundness of the BHC (or category of BHCs). We expect that implementation of this discretionary authority will become a focus for the FRB.

- \$250 Billion or More and U.S. GSIBs. BHCs with \$250 billion or more in total consolidated assets and U.S. GSIBs, regardless of asset size, continue to be subject to enhanced prudential standards.

As noted above, the Bill does not automatically eliminate the \$50 billion threshold in the variety of contexts in which it has come to be used, even though not mandated by statute (for example, the Volcker Rule, the Office of the Comptroller of the Currency's ("OCC") "heightened standards," the Federal Deposit Insurance Corporation's ("FDIC") living will requirement for insured depository institutions, and the U.S. intermediate holding company requirement that applies to foreign banking organizations). In fact, in language that arose during negotiations on Capitol Hill, the Bill specifically notes that it does not affect (1) the legal effect of the FRB's enhanced prudential standards as applied to foreign banking organizations with total consolidated assets equal to or greater than \$100,000,000,000 or (2) limit the FRB's authority to require the establishment of intermediate holding companies for such foreign banking organizations. As a result, the policy and regulatory process that is likely to be forthcoming to evaluate and determine how the \$50 billion asset threshold should be used elsewhere in the regulatory framework will be critical.

The Bill also includes several related changes and conforming amendments, including the following:

- Credit Exposure Reports. The Dodd-Frank Act mandated the FRB to adopt requirements for credit exposure reports by BHCs subject to enhanced prudential standards. Although regulations were proposed shortly after the Dodd-Frank Act's enactment, the FRB never finalized the standards. The Bill makes it discretionary, rather than mandatory, for the FRB to promulgate these regulations.
- Risk Committee for Publicly Traded BHCs. The asset threshold is raised from \$10 billion to \$50 billion for a publicly traded BHC's mandatory adoption of a risk committee.

- Stress Tests. The Bill makes the following changes with respect to stress tests (which apply based on the categories of BHCs outlined above):
 - *Supervisory Stress Tests*. The FRB's now periodic supervisory stress test requirement under section 165 is amended to have two scenarios (baseline and severely adverse), rather than three (baseline, adverse, and severely adverse).
 - *Company-Run Stress Tests*. Company-run stress tests currently are required either semi-annually (for \$50 billion-plus BHCs) or annually (for \$10 billion-plus BHCs). The Bill makes this a "periodic" requirement, providing the FRB discretion to determine the required frequency of the stress tests. The Bill also amends the requirement to have two scenarios (baseline and severely adverse), rather than three (baseline, adverse, and severely adverse).
- Supplementary Leverage Ratio. When calculating the supplementary leverage ratio (the "SLR"), custodial banks to which the SLR applies may exclude from the denominator funds deposited with qualifying central banks up to the amount of the bank's deposits linked to fiduciary or custodial and safekeeping accounts. A "custodial bank" is defined as any banking organization "predominantly engaged" in custody, safekeeping, and asset servicing activities.
- LCR. The FRB's version of the LCR treats certain municipal securities as level 2B high-quality liquid assets ("HQLA"). The Bill requires the FRB, the OCC and the FDIC to adopt changes to their respective LCR regulations to treat municipal obligations that are investment-grade, liquid, and readily marketable as level 2B high quality liquid assets under the LCR. The agencies also are required to treat such municipal obligations as HQLA for purposes of "any other regulation that incorporates a definition" of the term HQLA or a substantially similar term.
- Assessments. The asset threshold for various assessments are raised as follows:
 - *FRB Assessment*. The Bill raises the asset threshold that triggers special FRB supervisory assessments from \$50 billion to \$100 billion, and requires the FRB to tailor assessments for firms with assets between \$100 and \$250 billion.
 - *Financial Research Fund*. The asset threshold at which a BHC is subject to an assessment to fund the Office of Financial Research and Financial Stability Oversight Council is raised from \$50 billion to \$250 billion.
- Prior Notice for Large Acquisitions. The Bill limits the requirement to give prior notice to the FRB for larger acquisitions set forth in section 163(b) of the Dodd-Frank Act to BHCs with \$250 billion or more in assets (as well as nonbank financial

companies subject to FRB supervision). A similar requirement that was added by the Dodd-Frank Act to BHC Act section 4(k) has not been revised.

Regulatory Relief for Community Banks

The Bill provides regulatory relief to community banks by raising the asset thresholds for certain provisions of the Dodd-Frank Act, as well as other laws and regulations. These provisions include the following:

- Community Bank Leverage Ratio. Banking organizations with less than \$10 billion in assets are permitted to satisfy capital standards and are considered “well capitalized” under the prompt corrective action framework if their leverage ratio of tangible equity to average consolidated assets is between 8 and 10 percent, unless the relevant federal banking agency determines that the organization’s risk profile warrants a more stringent leverage ratio. The Bill requires federal banking agencies to adopt rules to implement this standard, including the procedures that would apply for such a banking organization that does not meet the leverage ratio the agencies adopt.
- Expansion of Small BHC and SLHC Policy Statement. The FRB is required to revise its Small Bank Holding Company and Savings and Loan Holding Company Policy Statement to cover BHCs and SLHCs with up to \$3 billion of assets (compared to \$1 billion today), thereby allowing those institutions to increase their holding company debt levels, subject to certain exceptions and criteria.
- Less Frequent Examination Schedule. The asset threshold that allows a well-managed and well-capitalized bank to adopt an 18-month examination cycle, rather than a 12-month cycle, is increased from \$1 billion to \$3 billion.
- Reciprocal Deposits. Subject to certain criteria, reciprocal deposits are not considered brokered deposits if the total reciprocal deposits do not exceed either \$5 billion or 20% of the total liabilities of the bank.

Volcker Rule Changes

Banking entities with less than \$10 billion in total assets and total trading assets and liabilities that comprise no more than 5% of total assets are exempt from the Volcker Rule.

In addition, the “name-sharing” restriction under the Volcker Rule’s asset management exemption no longer restricts a covered fund from sharing a name with an investment

adviser, so long as the investment adviser does not share the name of a depository institution, depository institution holding company, or foreign bank treated as a bank holding company, and does not use the word “bank” in its name.

Required Studies

Risks of Cyber Threats to U.S. Financial Institutions and Capital Markets

Within one year after enactment of the Bill, the Secretary of the Treasury is required to submit a report to Congress on the risks of cyber threats to U.S. financial institutions and capital markets, including:

- An assessment of the material risks of cyber threats.
- An analysis of the potential impact of those risks.
- A recommendation as to whether additional legal authority or resources are needed to appropriately address the identified risks.

Report on the Effects of Algorithmic Trading in U.S. Capital Markets

Within 18 months after enactment of the Bill, the SEC must submit a report to Congress on the risks and benefits of algorithmic trading in U.S. capital markets, covering:

- An assessment of the effect of algorithmic trading on access to liquidity, both in normal and stressed market conditions.
- An assessment of the benefits and risks to U.S. equity and debt markets.
- Whether the current federal supervision and regulation of algorithmic trading is appropriate.
- Recommendations as to whether current regulations should be changed or the SEC needs additional legal authorities or resources to address these issues.

* * *

Please do not hesitate to contact us with any questions.

NEW YORK

Gregory J. Lyons
gjlyons@debevoise.com

David L. Portilla
dlportilla@debevoise.com

Zila R. Acosta-Grimes
zracosta@debevoise.com

Jennifer T. Barrows
jbarrows@debevoise.com

Chen Xu
cxu@debevoise.com

WASHINGTON, D.C.

Satish M. Kini
smkini@debevoise.com

Appendix A: Illustration of Select Asset Threshold Changes

This chart illustrates how the Bill alters key regulatory requirements based on the level of a BHC’s assets. We highlight CCAR and the modified LCR below as critical items that do not appear to be directly affected by the Bill. In addition, the Bill does not affect the applicability thresholds for requirements that apply only to advanced approaches banking organizations and GSIBs, including the GSIB surcharge, total loss absorbing capacity requirements, the enhanced supplementary leverage ratio, the countercyclical capital buffer, the supplementary leverage ratio, the full LCR, and the advanced approaches capital rules.

 Regulatory requirement remains
  Regulatory requirement removed by the Bill
  See explanation

Regulatory Requirement	Asset Threshold	
	\$50-\$100 Billion	\$100-\$250 Billion ¹
Annual Company-Run Stress Tests (become “periodic”)	✓	✓
Semiannual Company-Run Stress Tests (become “periodic”)	✓	✓
Annual Supervisory Stress Tests	✓	FRB shall undertake periodic stress testing for these BHCs
Capital Plan/CCAR/Associated Reporting Requirements	Appears to require FRB Action	Appears to require FRB Action
Risk Committee for Publicly Traded BHCs	✗	✗
Risk Management Enhanced Prudential Standards	✓	✓
Liquidity Risk Management Enhanced Prudential Standards	✓	✓
Liquidity Stress Testing and Buffer Requirements	✓	✓
Modified LCR	Appears to require FRB Action	Appears to require FRB Action
BHC Resolution Planning (Living Wills)	✓	✓
Resolution Planning Requirement for Insured Depository Institutions (Federal Deposit Insurance Corporation Regulation)	✗	✗

¹ The FRB has discretionary authority to apply enhanced prudential standards to BHCs in this category.