Client Update
Bipartisan Consensus Emerges on Bank Regulatory Relief

On November 13, 2017, a bipartisan group of Senators announced their agreement on proposed legislation, the Economic Growth, Regulatory Relief and Consumer Protection Act, S.2155 (the "Senate Bill"), that would provide regulatory relief for a range of banking organizations, primarily but not exclusively focused on smaller firms.

The legislation would remove bank holding companies ("BHCs") with less than $100 billion in assets from the application of enhanced prudential standards, eliminate 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 maintain the status quo for U.S. global systemically important banks ("G-SIBs") and BHCs with more than $250 billion of assets. The Senate Bill would 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 would 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 are available on our website here.

We believe the issue of raising the $50 billion asset threshold has momentum in Washington and that this bill represents a significant step toward such a change becoming law. The Senate Bill covers a range of topics; this Client Update focuses on several aspects of the legislation. In addition to detailing the provisions regarding enhanced prudential standards, we describe how the Senate Bill would reduce regulatory requirements for community banks, revise discrete aspects of the Volcker Rule, and require the Treasury Department and Securities and Exchange Commission (the "SEC") to undertake studies of cyber risks and algorithmic trading, respectively.

REVISING THE DODD-FRANK ACT'S $50 BILLION ASSET THRESHOLD

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

- Less than $100 billion. Effective on the date of the Senate Bill's enactment, BHCs with total consolidated assets of less than $100 billion would no longer be subject to enhanced prudential standards.
- $100 to $250 billion. Within 18 months after the Senate Bill's enactment, BHCs with between $100 billion and $250 billion in total consolidated assets would be subject to a revised framework.
  - *Stress Testing*. The FRB would be 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 would not fall within the scope of this provision. The reason for this result is that the provision mandating such stress tests would not be incorporated into section 165 of the Dodd-Frank Act (that provision uses a broader definition of the term BHC that picks up foreign companies with any U.S. banking presence); instead, the provision would be enacted separate from section 165 and, per definitions included in the Senate Bill, the BHC Act's narrower definition of BHC would apply.
  - *Discretionary Measures*. The FRB would retain 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).
- $250 billion or more and U.S. G-SIBs. BHCs with $250 billion or more in total consolidated assets and U.S. G-SIBs, regardless of asset size, would continue to be subject to enhanced prudential standards.

An unsettled issue is exactly which of the requirements applicable to BHCs with $50 billion or more in assets that were adopted as part of the FRB's post-Dodd-Frank Act framework (e.g., requirements such as the FRB's capital plan rule and the full liquidity coverage ratio (the "LCR")) are meant to be affected by the legislation. This question arises because the FRB, when adopting various aspects of its post-Dodd-Frank Act regulatory framework, has relied on a number of authorities and has not always been clear when it relies on section 165. Further, the Senate bill would 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 (such as, for example, the

Volcker Rule, the Office of the Comptroller of the Currency's "heightened standards," and the U.S. intermediate holding company requirement that applies to foreign banking organizations).

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

- Credit Exposure Reports. The FRB currently is mandated 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 Senate Bill would make it discretionary, rather than mandatory, for the FRB to promulgate these regulations.
- Risk Committee for Publicly Traded BHCs. The asset threshold would be raised from $10 billion to $50 billion for a publicly traded BHC's mandatory adoption of a risk committee.
- Stress Tests. The Senate Bill would make two changes with respect to stress tests:
  - *Supervisory Stress Tests*. The FRB's annual supervisory stress test under section 165 would have two (baseline and severely adverse), rather than three (baseline, adverse, and severely adverse), scenarios.
  - *Company-run Stress Tests*. The requirement for company-run stress tests currently requires either semi-annual (for $50 billion-plus BHCs) or annual (for $10 billion-plus BHCs) exercises. This requirement would change to apply based on the categories of BHCs outlined above and would become a "periodic" requirement, providing the FRB discretion to determine the required frequency of the stress tests. Company-run stress tests would continue to require three (base, adverse, and severely adverse) scenarios.
- Supplementary Leverage Ratio. For purposes of calculating the supplementary leverage ratio (the "SLR"), the custodial banks (as defined below) to which the SLR applies would be permitted to exclude from the denominator funds deposited with qualifying central banks up to the amount of value of the bank's deposits linked to fiduciary or custodial and safekeeping accounts. A "custodial bank" is defined to mean any banking organization for which the level of assets under custody is not less than 30 times its total assets.
- LCR. Today, the FRB's version of the LCR treats certain municipal securities as level 2B HQLA. The Senate Bill would require the FRB, the Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation (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 would be 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 would be raised:
  - *FRB Assessment*. The Senate Bill would raise the asset threshold that triggers special FRB supervisory assessments to $250 billion. It is not entirely clear whether a $100 billion-$250 billion asset BHC would avoid such assessments if, as described above, the FRB were to subject the BHC to additional enhanced prudential standards on a discretionary basis. The Senate Bill also would remove the FRB's authority to collect assessments from savings and loan holding companies ("SLHCs") to fund the FRB's supervisory and regulatory responsibilities with respect to those companies.
  - *Financial Research Fund*. The threshold to be subject to an assessment to fund the Office of Financial Research and Financial Stability Oversight Council would be raised to $250 billion.
- Prior Notice for Large Acquisitions. The Senate Bill would limit the requirement for prior notice to the FRB for larger acquisitions required under 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) would not be revised.

REGULATORY RELIEF FOR COMMUNITY BANKS

The Senate Bill would provide 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 would be permitted to satisfy capital standards and be considered "well capitalized" under the prompt corrective action framework by meeting a leverage ratio of between 8 and 10 percent of tangible equity to average consolidated assets, unless the relevant federal banking agency determined that the organization's risk profile warrants a more stringent leverage ratio. The federal banking agencies would be required 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 would be 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 determines whether a well-managed and well-capitalized bank is subject to an 18-month examination cycle, rather than a 12-month cycle, would be increased from $1 billion to $3 billion in total assets.

- Reciprocal Deposits. Subject to certain criteria, reciprocal deposits would not be 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 would be exempt from the Volcker Rule.

In addition, the "name-sharing" restriction under the Volcker Rule's asset management exemption would not restrict 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 or depository institution 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 Senate Bill, the Secretary of the Treasury would be 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 the identified material risks of cyber threats; and
- A recommendation as to whether additional legal authority or resources are needed to appropriately address the identified material risks of cyber threats.

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

Within 18 months after enactment of the Senate Bill, the SEC would be required to 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; and
- Recommendations as to whether current regulations should be changed or the SEC needs additional legal authorities or resources to address these issues.

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Please do not hesitate to contact us with any questions.

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