Clients&FriendsMemo

Bank Deregulation Bill Becomes Law

May 25, 2018

On May 24, President Trump signed into law the most significant banking legislation since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in 2010. The bill – named the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Act") – passed its final legislative hurdle earlier this week when it was approved by the U.S. House of Representatives. Identical legislation passed the U.S. Senate last March on a bipartisan basis.

The Act makes targeted, but not sweeping, changes to several key areas of Dodd-Frank, with the principal beneficiaries of most provisions being smaller, non-complex banking organizations.

Below is a summary of several key changes:

- ***Higher SIFI Threshold*** – The controversial $50 billion asset threshold under Dodd-Frank is now $250 billion, affecting about two dozen bank holding companies. Under Section 165 of Dodd-Frank, bank holding companies with at least $50 billion in total consolidated assets were subjected to enhanced prudential standards. Under the Act, the enhanced prudential standards under Section 165 no longer apply to bank holding companies below $100 billion, effective immediately. Bank holding companies with total consolidated assets of between $100 billion and $250 billion will be exempted from such standards starting in November 2019, although the Federal Reserve retains the authority to apply the standards to any such company if it deems appropriate for purposes of U.S. financial stability or to promote the safety and soundness of the particular firm.

  The increase in the Section 165 threshold does not eliminate the $50 billion threshold used in other areas of regulation and supervision, such as the Office of the Comptroller of the Currency's ("OCC") "heightened standards," the "living will" regulations adopted by the Federal Deposit Insurance Corporation ("FDIC") for insured depository institutions or the Federal Reserve's capital plan rule pursuant to which it administers the CCAR process. However, it is expected that the federal

banking agencies may reconsider the appropriateness of using the $50 billion asset threshold elsewhere.

The increase in this threshold is especially important because it may spark renewed interest in M&A opportunities among regional banks that have carefully managed growth to avoid crossing $50 billion or that have otherwise been reluctant to pursue transactions in light of the significant regulatory scrutiny that has accompanied applications by large acquirors.

- ***Volcker Rule*** – The Volcker Rule is amended so that it no longer applies to an insured depository institution that does not have, and is not controlled by a company that has, (i) more than $10 billion in total consolidated assets and (ii) total trading assets and trading liabilities that are more than 5% of total consolidated assets. All other banking entities, however, remain subject to the Volcker Rule. The other change to the Volcker Rule relates to the name-sharing restriction under the asset management exemption, which the Act modifies slightly by easing the prohibition on banking entities sharing the same name with a covered fund for marketing or other purposes. Going forward, a covered fund may share the same name as a banking entity that is the investment adviser to the covered fund as long as the word "bank" is not used in the name and the investment adviser is not itself (and does not share the same name as) an insured depository institution, a company that controls an insured depository institution or a company that is treated as a bank holding company. This change allows separately branded investment managers within a bank holding company structure to restore using the manager's name on its advised funds.

  The Act represents only the first set of changes to the Volcker Rule. The federal banking agencies are expected to release a proposal the week of May 28 to revise aspects of the regulations first adopted in late 2013.

- ***"Off-Ramp" Relief for Qualifying Community Banks*** – A depository institution or depository institution holding company with less than $10 billion in total consolidated assets will constitute a "qualifying community bank" under the Act. The benefit of such a designation is that the institution will be exempt from generally applicable capital and leverage requirements, provided the institution complies with a leverage ratio of between 8% and 10%. The federal banking agencies must develop this ratio and establish procedures for the treatment of a qualifying community bank that fails to comply. The regulators have the authority to determine that a depository institution or depository institution holding company is not a qualifying community bank based on the institution's risk profile.

- ***Stress Testing*** – The Act provides relief from stress testing for certain banking organizations. Notably, bank holding companies with total consolidated assets of

between $10 billion and $250 billion will no longer need to conduct company-run stress tests. Bank holding companies with more than $250 billion in assets and nonbank companies deemed systemically important still need to conduct company-run stress tests, but are permitted to do so on a "periodic" basis rather than the previously required semi-annual cycle. As for supervisory stress tests, which are conducted by the Federal Reserve, bank holding companies with less than $100 billion are no longer subject to such stress tests. Bank holding companies with total consolidated assets between $100 billion and $250 billion are subject to supervisory stress tests on a periodic basis, while such firms with $250 billion or more in total consolidated assets and nonbank companies designated as systemically important remain subject to annual supervisory stress tests.

- ***Risk Committees and Credit Exposure Reports*** – The Act raises the asset threshold that triggers the need for publicly-traded bank holding companies to establish a board-level risk committee, from $10 billion to $50 billion. In addition, the Act amends Dodd-Frank's requirement that bank holding companies with at least $50 billion in assets and nonbank companies designated as systemically important submit credit exposure reports. Instead, the Act authorizes, but does not mandate, the Federal Reserve to receive reports from these firms, but with respect to bank holding companies, only those with more than $250 billion in assets are within scope.
- ***Exam Cycle and Call Report Relief for Smaller Institutions*** – The Act increases the asset threshold for insured depository institutions to qualify for an 18-month on-site examination cycle from $1 billion to $3 billion. The Act also directs the federal banking agencies to adopt short-form call reports for the first and third calendar quarters for insured depository institutions with less than $5 billion in total consolidated assets and that meet such other criteria as the agencies determine appropriate.
- ***Small BHC and SLHC Policy Statement*** – The asset threshold for the application of the Federal Reserve's Small Bank Holding Company and Savings and Loan Holding Company Policy Statement is raised from $1 billion to $3 billion. As a result, those institutions with less than $3 billion in consolidated assets are not subject to consolidated capital requirements and have the benefit of less restrictive debt-to-equity limitations.
- ***Flexibility for Federal Thrifts to Operate as National Banks*** – Federal savings associations with total consolidated assets of $20 billion or less (as of December 31, 2017) may elect to be subject to the same rights, privileges, duties, restrictions, penalties, liabilities, conditions and limitations that apply to a national bank, without having to convert their charters. As a result, institutions that make the election would be exempt from certain restrictions unique to savings associations, including asset-

based limitations applicable to commercial and consumer loans, unsecured constructions loans, and non-residential real property loans. To make an election, a federal savings association must provide 60 days' prior written notice to the OCC.

- ***"Ability to Repay" Safe Harbor for Smaller Institutions*** – The Act provides a safe harbor from the "ability to repay" requirement under the Truth in Lending Act ("TILA") for mortgage loans originated and retained in portfolio by an insured depository institution or insured credit union that has, together with its affiliates, less than $10 billion in total consolidated assets. However, mortgage loans that have interest-only, negative amortization or certain other features do not qualify for this ability-to-repay relief.
- ***Capital Treatment for HVCRE Exposures*** – The Act eases the treatment for certain "high-volatility commercial real estate" ("HVCRE") loans under U.S. Basel III capital rules. HVCRE exposures had been assigned a 150% risk-weight under the U.S. standardized approach, but the Act now restricts this higher risk-weight to those exposures that constitute acquisition, development and construction ("ADC") loans meeting a new "HVCRE ADC loan" definition. Various loans are excluded from HVCRE ADC loan definition, including loans to finance the acquisition, development or construction of one- to four-family residential properties, community development project loans, and loans secured by agricultural land. In addition, loans to acquire, refinance or improve income-producing properties and commercial real estate projects that meet certain loan-to-value ratios are also excluded from the new HVCRE ADC loan definition.
- ***Reciprocal Deposits*** – The Act excludes deposits received under a reciprocal deposit placement network from the scope of the FDIC's brokered deposit rules if the agent institution's total amount of reciprocal deposits does not exceed either $5 billion or 20% of the institution's total liabilities. The exclusion applies generally to a bank that has a composite condition of outstanding or good and is well capitalized, but it may be relied upon by a bank that has been downgraded or ceases to be well capitalized if the amount of reciprocal deposits it holds does not exceed the average of its total reciprocal deposits over the four quarters preceding its rating or capital downgrade.
- ***PACE Financing*** – The Act requires the Consumer Financial Protection Bureau ("CFPB") to issue ability-to-repay rules under TILA to cover Property Assessed Clean Energy ("PACE") financing. The Act defines such financing to include a loan that covers the costs of home improvements and which results in a tax assessment on the consumer's real property. In developing these regulations, the CFPB must consult with state and local governments and PACE bond-issuing authorities.

- ***Protections for Student Borrowers*** – The Act provides protections for student loan borrowers in situations involving the death of the borrower or cosigner and those seeking to "rehabilitate" their student loans. In particular, the Act amends TILA to prohibit a private education loan creditor from declaring a default or accelerating the debt of the student obligator solely on the basis of the death or bankruptcy of a cosigner. In addition, in the case of the death of the borrower, the holder of a private education loan must release any cosigner within a "reasonable timeframe" after receiving notice of the borrower's death. The Act also amends the Fair Credit Reporting Act by allowing a borrower to request that a financial institution remove a reported default on a private education loan from a consumer credit report if the institution offers and the borrower successfully completes a loan rehabilitation program. The program, which must be approved by the institution's federal banking regulator, must require that the borrower make consecutive on-time monthly payments in a number that, in the institution's assessment, demonstrates a "renewed ability and willingness to repay the loan."
- ***Immunity from Suit for Disclosure of Financial Exploitation of Senior Citizens*** – The Act shields financial institutions and certain of their personnel from civil or administrative liability in connection with reports of suspected exploitation of senior citizens. The reports must be made in good faith and with reasonable care to a law enforcement agency or certain other designated agencies, including the federal banking agencies. Personnel covered by the immunity (which include compliance personnel and their supervisors, as well as registered representatives, insurance producers and investment advisors) must have received training in elder care abuse by the financial institution or a third party selected by the institution.
- ***Mortgage Relief*** – The Act contains a number of provisions easing certain residential mortgage requirements, especially with respect to such loans made by smaller institutions. The Act amends the Home Mortgage Disclosure Act to exempt from specified public disclosure requirements depository institutions and credit unions that originate, on an annual basis, fewer than a specified number of closed-end mortgages or open-end lines of credit. The Act revises the Federal Credit Union Act to allow a credit union to extend a member business loan with respect to a one- to four-family dwelling, regardless of whether the dwelling is the member's primary residence. The Act also amends the S.A.F.E. Mortgage Licensing Act of 2008 to allow loan originators that meet specified requirements to continue, for a limited time, to originate loans after moving: (i) from one state to another, or (ii) from a depository institution to a non-depository institution. Further, the Act exempts from certain escrow requirements a residential mortgage loan held by a depository institution or credit union that: (i) has assets of $10 billion or less, (ii) originated 1,000 or fewer mortgages in the preceding year, and (iii) meets other specified requirements.

- ***Liquidity Coverage Ratio*** – The Act directs the federal banking agencies to amend their liquidity coverage ratio requirements to permit certain municipal obligations to be treated as higher quality "level 2B" liquid assets if they are investment grade, liquid and readily marketable.
- ***Custodial Bank Capital Relief*** – The Act requires the agencies to exclude, for purposes of calculating a custodial bank's supplementary leverage ratio, funds of a custodial bank that are deposited with a central bank. The amount of such funds may not exceed the total value of deposits of the custodial bank linked to fiduciary or custodial and safekeeping accounts.
- ***Fair Credit Reporting Act*** – The Fair Credit Reporting Act is amended to increase the length of time a consumer reporting agency must include a fraud alert in a consumer's file. The Act also: (i) requires a consumer reporting agency to provide a consumer with free "credit freezes" and to notify a consumer of their availability, (ii) establishes provisions related to the placement and removal of these credit freezes and (iii) creates requirements related to the protection of the credit records of minors.
- ***Cyber Threat Report*** – Within one year of enactment, the Secretary of the Treasury must submit a report to Congress on the risks of cyber threats to U.S. financial institutions and capital markets. The report must include: (i) an assessment of the material risks of cyber threats, (ii) the impact and potential effects of material cyber attacks, (iii) an analysis of how the federal banking agencies and the Securities and Exchange Commission are addressing these material risks and (iv) a recommendation of whether additional legal authorities or resources are needed to adequately assess and address the identified risks.

Apart from the changes in the thresholds for banks with assets above $100 billion, most of the Act's provisions are effective immediately.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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