March 16, 2018

Senate Passes Financial Regulatory Reform Bill

On March 14, 2018, the U.S. Senate passed S. 2155, the "Economic Growth, Regulatory Relief, and Consumer Protection Act."[1] If enacted into law, S. 2155 would provide modest regulatory relief to regional and community banks, among other things. The bill passed the Senate with bipartisan support through a vote of 67 to 31, with 17 Democrats[2] supporting the measure.

S. 2155 will now be considered by the U.S. House of Representatives. In 2017, the House passed its own financial regulatory reform measure, H.R. 10, the "Financial CHOICE Act of 2017," but that bill is not expected to become law or to be incorporated into the Senate bill.[3] In addition to H.R. 10, the House has separately passed several smaller standalone measures with bipartisan support.

The Senate and House will now negotiate the final language of a financial regulatory reform bill. It is anticipated that the House will not accept S. 2155 without seeking amendments that would incorporate some of the legislation it has previously passed. However, as the Senate bill was heavily negotiated in order to gain Democratic support, material differences from S. 2155 that emerge from negotiations with the House could upend the bipartisan coalition needed for final passage in the Senate.

Below is a general summary of some of the principal components of S. 2155.

- **Enhanced Prudential Standards.** Section 165 of the Dodd-Frank Act imposed enhanced prudential standards (EPS) on bank holding companies with $50 billion or more in total consolidated assets. Under S. 2155, the Board of Governors of the Federal Reserve System ("Federal Reserve") would be required to apply EPS only to bank holding companies with $250 billion in total consolidated assets and any bank holding companies, regardless of asset size, that have been identified as global systemically important bank holding companies. The Federal Reserve would also be authorized, though not required, to apply EPS to bank holding companies with total consolidated assets of $100 billion or more. In addition to relaxing the threshold for application of EPS, S. 2155 would require the Federal Reserve to tailor EPS on an individual basis or by category; such tailoring is optional under current law.
    - **Clarification for Foreign Banks.** Currently foreign banking organizations with total consolidated assets of $50 billion or more are subject to EPS. A provision in the Senate bill clarifies that the relaxation of the thresholds for application of EPS would not exempt foreign banking organizations with total consolidated assets of $100 billion or more from the Federal Reserve's current EPS rules.

[1] The text of the bill is available here. A section-by-section summary of the bill, as passed out of the Senate Banking Committee, is available here.

[2] This includes one independent senator, Angus King (I-ME), who caucuses with the Democrats.

[3] For more information regarding the Financial CHOICE Act of 2017, please see our client alerts: "The Financial Choice Act: Implications for the U.S. Securities Legal Framework," "U.S. House of Representatives Passes the Financial CHOICE Act of 2017," and "House Passes Regulatory Reform That Would Loosen Restrictions on BDCs and Other Funds."

- **Stress Testing.** S. 2155 would modify the Dodd-Frank Act stress testing requirements. First, the threshold for bank holding companies to become subject to an annual supervisory stress test conducted by the Federal Reserve would be raised to $250 billion, and such stress tests would only be conducted under two scenarios (baseline and severely adverse) rather than the current three (baseline, adverse, and severely adverse). Bank holding companies with total consolidated assets of $100 billion or more, but less than $250 billion, would be subject to supervisory stress tests conducted by the Federal Reserve on a periodic basis. Second, S. 2155 would set the threshold for requiring financial companies and bank holding companies to conduct company-run stress tests at $250 billion and would require such company-run stress tests to be conducted only on a periodic basis (rather than semi-annually or annually as applicable). Finally, such company-run stress tests would also need to be conducted only under two scenarios (baseline and severely adverse) rather than the current three (baseline, adverse, and severely adverse).

- **Custody Banks.** The Senate bill would provide relief from capital regulations for large custodial banks. The bill would require capital regulations to specify that funds of a custodial bank deposited with a central bank will not be taken into account when such custodial bank calculates the supplementary leverage ratio. A "custodial bank" is a bank predominately engaged in custody, safekeeping, and asset servicing activities.

- **Treatment of Municipal Obligations under LCR Final Rule.** For purposes of the Liquidity Coverage Ratio final rule,[4] S. 2155 would direct the banking agencies to treat municipal obligations as level 2B liquid assets if they are (a) liquid and readily-marketable; and (b) investment grade.

- **Volcker Rule.** The Senate bill would make two changes to Section 13 of the Bank Holding Company Act (the "Volcker Rule"). First, the bill would exempt from the Volcker Rule insured depository institutions that (i) have $10 billion or less in total consolidated assets; and (ii) have total trading assets and trading liabilities that are less than 5% of total consolidated assets. Second, the Senate bill would amend the asset management exemption. Currently, one of the conditions for reliance on the asset management exemption is that the banking entity does not share the same name as the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes. Under S. 2155, a banking entity that is an investment adviser to a hedge fund or private equity fund and is not an insured depository institution could share the same name as the hedge fund or private equity fund (subject to certain conditions) and still rely on the asset management exemption.

- **High Volatility Commercial Real Estate Exposures.** S. 2155 would provide clarity to the capital treatment of acquisition, development, and construction (ADC) loans characterized as high volatility commercial real estate (HVCRE) exposures. This section of the bill would address concerns expressed by banks and industry groups regarding the complexity of the current HVCRE exposure rule and its uncertain application. In November 2017, the House passed H.R. 2148, which includes nearly identical language, so inclusion of this section in a final regulatory reform measure is likely.[5]

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[4] *See* 79 Fed. Reg. 61439 (October 10, 2014).

[5] For more information on H.R. 2148, please see our client alert. The Federal Reserve, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation are currently pursuing a parallel rulemaking process that would also make changes to the capital treatment of ADC loans. For more information on the federal banking agencies' parallel rulemaking process, please see our client alert. It is not known whether the banking agencies would continue their rulemaking process if the HVCRE legislation is adopted.

- **Community Bank Leverage Ratio.** The Senate bill would require the federal banking agencies to greatly simplify the capital requirements for qualifying community banks (i.e., insured depository institutions with total consolidated assets of less than $10 billion and the requisite risk profile). Specifically, qualifying community banks that exceed a leverage ratio set by the federal banking agencies (required to be set between 8% and 10%) would be deemed to be in compliance with all other generally applicable leverage capital and risk-based capital requirements.
- **Expanded Examination Cycle.** The Senate bill would extend the examination cycle to 18-months for banks that are well-managed and well-capitalized and have total assets of less than $3 billion. The current threshold for the expanded examination cycle is set at less than $1 billion.
- **Treatment of Small Savings Associations.** S. 2155 would permit Federal savings associations with total consolidated assets of $20 billion or less to have the same rights and privileges as national banks without converting to a national bank charter.

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