SQUIRE PATTON BOGGS

Regulatory Relief In Sight As House Eyes More Reforms

On May 22, 2018, the US House of Representatives passed S. 2155, Economic Growth, Regulatory Relief, and Consumer Protection Act.

The bill, which the Senate passed on March 14, 2018, provides regulatory relief to regional and small banks from various requirements stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This alert summarizes the key provisions of S. 2155 – which the President signed into law on May 24 – and analyzes how the debate over regulatory reform is expected to play out over the remainder of the 115th Congress.

Regulatory Relief for Regional Banks

Section 401. Enhanced Supervision and Prudential Standards for Certain Bank Holding Companies

This section increases the dollar thresholds in the Dodd-Frank Act related to the application of enhanced prudential standards to bank holding companies by the Federal Reserve Board (Board). Those standards include risk-based and leverage capital requirements, liquidity standards, resolution plans, requirements for overall risk management (including establishing a risk committee) and stress-test requirements. Currently, these enhanced standards apply to all bank holding companies with more than US$50 billion in assets. The Dodd-Frank Act also requires all publicly traded bank holding companies with more than US$10 billion in assets to establish a risk committee of the board of directors to oversee enterprise-wide risk, and requires all "other financial companies" with more than US$10 billion in assets (e.g., banks, savings associations, savings and loan holding companies) to conduct annual company-run stress tests.

Under this section, bank holding companies with less than US$100 billion in assets would be exempt from enhanced prudential standards immediately upon enactment. Bank holding companies with between US$100 billion and US$250 billion in assets would be exempt from enhanced prudential standards 18 months after enactment, unless the Board exercises discretionary authority to relieve an individual bank holding company in this size category from any of the prudential standards prior to that date. Bank holding companies with more than US$250 billion in assets would not receive any relief from enhanced prudential standards.

Bank holding companies with between US$100 billion and US$250 billion in assets would remain subject to supervisory stress tests conducted by the Board. Those tests would be conducted "periodically" and would test whether a company has the capital to absorb losses under an "adverse" economic scenario. Moreover, this section of the Senate bill gives the Board the authority to apply, by rule or order, enhanced prudential standards to bank holding companies with more than US$100 billion in assets if the Board finds that the standards are needed to address risks to the financial stability of the US or promote safety and soundness. Thus, the Board could decide to retain some of the standards for companies in this category. Additionally, this section does not eliminate similar requirements imposed by other agencies under independent authority, such as the resolution plans required by the Federal Deposit Insurance Corporation for insured depository institutions with more than US$50 billion in assets.

This section also increases the asset threshold for company-run stress tests by "other financial companies" (e.g., banks, savings associations, and savings and loan holding companies). That threshold is increased from US$10 billion to US$250 billion. Therefore, banks, savings associations, and savings and loan holding companies in this category would be exempt from the company-run tests, unless the federal regulator for the company decides to impose such a requirement based upon other provisions of law (e.g., general safety and soundness authority). For companies above that new threshold, the test would be periodic, not annual, and the relevant federal supervisor for the company would provide two scenarios for the test, a baseline and a severely-adverse scenario.

Finally, this section increases the asset threshold related to the requirement for bank holding companies to establishing a risk committee. That asset threshold would increase from US$10 billion to US$50 billion.

A table summarizing these changes can be found at the end of this alert.

Section 403. Treatment of Certain Municipal Obligations

This section directs the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) to classify qualifying investment-grade, liquid and readily-marketable municipal securities as level 2B liquid assets under the agencies' Liquidity Coverage Ratio final rule.

Regulatory Relief for Small Banks

Section 101. Minimum Standards for Residential Mortgage Loans

This section creates a safe harbor from the Ability to Repay/ Qualified Mortgage requirement for community banks, thrifts and credit unions with less than US$10 billion in consolidated assets (covered institutions). Specifically, to meet the safe harbor, and thus be considered to meet the ability to repay test, the mortgage from the covered institution must (1) be held in portfolio; (2) not include a prepayment penalty; (3) have points and fees that do not exceed 3% of the loan amount; and (4) not have negative amortization or interest only features. The covered institution also must document the debt, income and financial resources of the consumer. This documentation requirement can be met through various means and is not intended to require compliance with Appendix Q.

The safe harbor does not transfer to another institution when a mortgage is sold or transferred, unless the sale or transfer is (1) to another community bank or credit union with less than US$10 billion in consolidated assets and that bank or credit union holds the loan in portfolio; (2) in connection with a bankruptcy or failure of the institution or credit union; (3) part of a merger with another institution (of any size) and the loan is retained in portfolio; or (4) to a wholly owned subsidiary provided the loan is considered an asset of the covered institution for regulatory accounting purposes.

Section 108. Escrow Requirements Relating to Certain Consumer Credit Transactions

Under current law, mortgage lenders must establish escrow accounts for property tax and insurance payments for higher-priced mortgages. This section would exempt small insured banks, thrifts and credit unions from this requirement. An institution would qualify for the exemption if (1) it has assets of US$10 billion or less; (2) it originated fewer than 1,000 first mortgage loans in the preceding calendar year; (3) in the preceding calendar year, it originated a residential mortgage in a rural or underserved area; and (4) it and its affiliates do not maintain escrow accounts for property taxes and insurance for residential mortgages other than (i) escrow accounts for higher-priced mortgage loans made between April 1, 2010 and May 1, 2016; or (ii) escrow accounts established after consummation as an accommodation to distressed consumers to assist in avoiding default or foreclosure. However, an escrow account must be established for a loan that, at consummation, is subject to a commitment to be acquired by a person that does not satisfy the conditions of this exemption.

Section 201. Capital Simplification for Qualifying Community Banks

This section directs the federal banking agencies to establish leverage ratio of tangible equity to average consolidated assets of not less than 8% and not more than 10% for banks and thrifts with less than US$10 billion in total consolidated assets. If an institution meets this leverage ratio, it would be (1) exempt from Basel III risk-based and leverage requirements; and (2) treated as "well capitalized" for purposes of the prompt corrective action regime, which imposes regulatory conditions on institutions that are not well capitalized.

Section 203. Community Bank Relief

This section provides an exemption from the Volcker Rule for an institution that has or is controlled by a company that has less than US$10 billion in total consolidated assets and has total trading assets and trading liabilities of no more than 5% of total consolidated assets.

Other Key Provisions

Section 103. Exemption from Appraisals of Real Property Located in Rural Areas

This section creates an exemption from federal appraisal requirements for banks, thrifts and credit unions if (1) a property is located in a rural area; (2) the bank or credit union can document that an appraiser is not available within a "reasonable amount of time;" and (3) the transaction value is less than US$400,000.

In order to document that an appraiser is not available within a "reasonable amount of time," a bank or credit union must contact at least three state certified appraisers or state licensed appraisers within three days of the closing disclosure required under the TRID rule. The provision places certain restrictions on the sale or transfer of a loan made under this exemption. The provision includes anti-evasion measures and also permits the federal financial institution regulatory agencies to find that the exemption does not apply for safety and soundness concerns.

Section 106. Eliminating Barriers to Jobs for Loan Originators

This section provides temporary licensing authority for loan originators who switch employment from a depository institution to a state-licensed mortgage company and for state-licensed loan originators who move to another state. The section is effective 18 months after the date of enactment of the bill.

Section 109. No Wait for Lower Mortgage Rates

This section eliminates the three-day waiting period required for the closing disclosure required under TRID if a creditor extends a second offer of credit that has a lower APR. The section also encourages, but does not require, the CFPB to provide guidance on the applicability of the TRID Rule to (1) mortgage assumption transactions; (2) construction-to-permanent home loans; and (3) the extent to which lenders can rely upon model disclosures published by the CFPB without liability if recent changes to regulations are not reflected in the sample TRID forms published by the CFPB.

Section 206. Option for Federal Savings Associations to Operate as Covered Savings Associations

This section permits federal savings associations with less than US$20 billion in total consolidated assets as of December 31, 2017, to elect to operate with the same powers and duties as national banks without being required to convert their charters. The OCC would be required to issue rules to establish streamlined standards and procedures for such election. Subject to the OCC's rules, a savings association that makes this election may continue to operate under the election if, after the election is made, the association has total consolidated assets greater than US$20 billion.

Section 213. Making Online Banking Initiation Legal and Easy

This section would authorize a depository institution, credit union or their affiliate to record personal information from a scan, copy or image of an individual's driver's license or personal identification card and store the information electronically when an individual initiates an online request to open an account or obtain a financial product. The institution may use the information to verify the authenticity of the driver's license or identification card, verify the identity of the individual or to comply with legal requirements. The institution must delete any copy or image of the driver's license or identification card after use.

Section 214. Promoting Construction and Development on Main Street

Under this section, a depository institution would only be required to assign a heightened risk weight to a high volatility commercial real estate (HVCRE) exposure under any risk-based capital requirement if such acquisition, development or construction loan meets certain thresholds signaling increased risk.

Section 215. Reducing Identity Fraud

This provision directs the Social Security Administration to establish a database to facilitate financial institutions' validation of an individual's name, social security number and date of birth to combat synthetic identity fraud.

Section 313. Foreclosure Relief and Extension for Servicemembers

This provision makes permanent the Servicemembers Civil Relief Act foreclosure protection for one year after active duty.

What Is Next for Regulatory Reform?

As noted above, the President signed the legislation into law on May 24, 2018. That said, it is important to note that enactment comes after months of negotiations between the two Chambers over the breadth and scope of what such legislation should include. The House, led by Financial Services Committee Chairman Jeb Hensarling (R-TX), had pushed for the Senate to move a more sweeping Dodd-Frank overhaul, similar to H.R. 10, CHOICE Act, which the House passed nearly a year before the Senate passed its bill.

However, recognizing that the Senate would face an uphill climb in securing the 60 votes needed to pass another bill, Chairman Hensarling and House Republican leadership reached an agreement with the Upper Chamber to take up their bill, as passed, on the promise that the Senate would consider additional reforms not addressed in its bill. As such, now that President Trump has signed the bill into law, it is expected that the House will put together and pass a package of additional reforms, which it will then send to the Senate. Until the full contents of that package are known, it is difficult to fully assess the seriousness of the Senate's promise to "consider" the House legislation. That said, regardless of the content, it remains unlikely that much else will get done this Congress beyond what is proposed by the Senate's regulatory relief package.

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Application of Enhanced Prudential Standards Under Section 401 of S. 2155

	Below US$50 billion	Between US$50 billion and US$100 billion	Between US$100 billion to US$250 billion	US$250 billion or more
Application of Enhanced Prudential Standards	N/A	Exempt upon enactment.	Exempt 18 months after enactment, but the Board may grant earlier relief by order. Also, by rule or order, the Board may apply any prudential standard to a company in this category if the Board determines that (1) the standard is needed to prevent or mitigate risks to the financial stability of the US, or (2) the standard would promote the safety and soundness of the company or companies. In making this determination, the Board is required to consider the company's or companies' capital structure, riskiness, complexity, financial activities, size and other risk factors.	Remain subject to enhanced prudential standards.
Risk Committee	Threshold for risk committee raised from US$10 billion to US$50 billion; companies below US$50 billion not required to have risk committee.	Risk committee required.	Risk committee required.	Risk committee required.
Supervisory Stress Test	N/A	Exempt.	Effective 18 months after date of enactment, the Board shall conduct periodic stress tests using adverse scenarios.	Companies remain subject to annual supervisory test, but the Board must use only two economic scenarios: baseline and severely adverse.
Company Run Stress Tests	Asset threshold for annual company run tests by financial companies (i.e., IDIs and SHLCs) increased from US$10 billion to US$250 billion. Therefore, financial companies with more than US$10 billion would be exempt from this requirement, unless the federal regulator for the institution imposes a similar requirement under other authority (e.g., safety and soundness standards).	Exempt, unless the federal regulator for the institution imposes a similar requirement under other authority (e.g., safety and soundness standards).	Exempt, unless the federal regulator for the institution imposes a similar requirement under other authority (e.g., safety and soundness standards).	BHCs and other financial companies (i.e., IDIs and SHLCs) with more than US$250 billion in assets remain subject to company run stress test requirement, but frequency changes to periodic and test involves only two scenarios: baseline and severely adverse.
CCAR	N/A	CCAR still applies, so companies in this category will need to conduct stress testing for purposes of CCAR.	CCAR still applies, so companies in this category will need to conduct stress testing for purposes of CCAR.	CCAR still applies.

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