

Financial Services Regulatory Reform

SUMMER SPOTLIGHT EDITION



June 3, 2019

These slides are designed to be a reference tool for the financial regulatory reform landscape. They gather in one place the state of play on a number of topics and set forth our views on the general outlook. They will be updated from time to time. To stay up to date on all topics related to financial regulatory reform, we invite you to visit our one-stop website and blog at www.FinRegReform.com.

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Momentum for Change Continues to be Agency-Driven

Financial regulatory reform, reflecting recent statutory mandates and the perspectives of the current administration and agency leadership, will continue to occur through a mix of regulations, interpretations and guidance, with the courts engaged by stakeholders on all sides.

State of Play: The New Congress

Congressional Priorities	<ul style="list-style-type: none">• Both the Chairwoman of the House Financial Services Committee, Rep. Waters, and the Chairman of the Senate Banking Committee, Sen. Crapo, have been vocal about their legislative agendas for this Congress.• Both committees are focusing on sanctions, GSE reform, financial services innovation and credit reporting; hearings on a number of topics have already occurred. Chairman Crapo is also focusing on capital formation and data privacy and security, while Chairwoman Waters is emphasizing consumer protection and diversity initiatives.• We expect the sharply partisan backdrop of Congressional investigations and communications across a range of issues to continue through this Congress.
Legislative Implementation	<ul style="list-style-type: none">• The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), enacted in May 2018 with significant bipartisan support, impacts a number of areas of financial regulation, and its implementation has been high on agency leaders' agendas since its passage.• The prospects for passage of further reform legislation in the next two years are uncertain in the now-divided Congress. Proposals are already emerging, but concrete progress will be seen only in those limited areas with bipartisan support or where there is an appetite for extensive negotiation and compromise.
Regulators Forge Ahead	<ul style="list-style-type: none">• Even absent additional legislation, the federal agencies have a full roster of regulatory reform priorities and new initiatives to complement ongoing efforts to implement statutory mandates, including EGRRCPA, and the finalization of Basel III. At a May 16, 2019 hearing before the House Financial Services Committee, Vice Chairman for Supervision Quarles stated that the agencies are on track to complete EGRRCPA rulemaking by the end of 2019.• The agencies' agendas will likely continue to be informed by the Treasury Department reports (Treasury Reports) on the conformity of U.S. financial regulations to the core principles (Core Principles) enumerated by President Trump in a February 2017 Executive Order, links to which are provided in the APPENDIX.• The agencies are facing extensive scrutiny from both sides of the aisle, with Democrats critical of the Trump Administration's "deregulatory agenda" for the financial sector, and Republicans focused on the pace of EGRRCPA implementation and the potential adoption of additional recommendations from the Treasury Reports.

Rating Systems and Governance

- **General Outlook:** The Federal Reserve is expected to finalize this year a set of recalibrated supervisory expectations for boards of directors (**Board Effectiveness Guidance**). There is also a proposal on senior management, the management of business lines and IRM (**Management Guidance**). Our visual memorandum discussing the proposed Board Effectiveness Guidance and Management Guidance in detail is available [here](#).
- **Five Key Attributes:** The proposed Board Effectiveness Guidance identifies five key attributes of effective boards.
- **LFI Rating System:** When finalized, the Board Effectiveness Guidance and Management Guidance will be used to inform the governance and controls component of the Federal Reserve's new rating system for large financial institutions (**LFIs**). Until then, an LFI will be evaluated for purposes of the governance and controls component based on existing supervisory guidance.
 - Even though the Board Effectiveness Guidance is not yet final, the Federal Reserve's [May 2019 Supervision and Regulation Report](#) states that board effectiveness is a 2019 horizontal supervisory priority for LISCC firms as part of the Federal Reserve's evaluation of those firms' governance and controls.
- **CAMELS Ratings:** Separately, FDIC Chairman McWilliams has expressed a desire to review the CAMELS ratings system for insured depository institutions, which was last updated in 1996. She has asked FDIC staff to develop options for working with other FFIEC members to seek public input on potential modernization, including on consistency of ratings across institutions and on the impact of ratings on supervisory actions such as enforcement proceedings and applications reviews.

Proposed Board Effectiveness Guidance – Five Key Attributes

1. Set clear, aligned and consistent direction regarding firm's strategy and risk tolerance
2. Actively manage information flow and board discussions
3. Hold senior management accountable
4. Support the independence and stature of the firm's independent risk management and internal audit functions
5. Maintain a capable board composition and governance structure

Examinations

- **There is a consensus among banking regulators that examination and supervision needs to be more efficient, transparent and fair.**
 - Vice Chairman for Supervision Quarles has stated regulatory efficiency could “mean simpler examination procedures for bank supervisors, or less intrusive examinations for well managed firms.”
 - FDIC Chairman McWilliams’ “Trust Through Transparency” initiative aims to “transform the FDIC – in terms of technology, examination processes, and culture – to enhance the stability of the financial system, protect consumers, and reduce the compliance burden on regulated institutions.”
- **These sentiments echo the Treasury Report issued in June 2017, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (Treasury Banking Report), which recommended that regulators:**
 - Improve the coordination of their examination activities and rationalize their examination and data collection procedures to promote accountability and clarity
 - Conduct an inter-agency reassessment of the volume of matters requiring attention (**MRAs**), matters requiring immediate attention (**MRIs**), and consent orders
 - Develop an improved approach to clearing regulatory actions to reduce multiyear delays
- **As part of their long-term Examination Modernization Project, the FFIEC members (the Federal Reserve, FDIC, NCUA, OCC and the CFPB) have been focusing their initial efforts on:**
 - Highlighting and reinforcing regulator communication objectives before, during, and after examinations
 - Leveraging technology and shifting, as appropriate, examination work from onsite to offsite
 - Continuing to tailor examinations based on risk
 - Improving electronic file transfer systems to facilitate the secure exchange of information between institutions and supervisory offices or examiners

For more information on the FDIC’s “Trust Through Transparency” initiative, please visit the [FinReg](#) blog – “[A Breath of Fresh Air at the FDIC](#)” (Oct. 5, 2018).

Examinations

- **In February 2018, the Federal Reserve proposed to streamline and expedite the process for appealing material supervisory determinations (MSDs) by:**
 - Reducing the levels of appeal from three to two and requiring that each appeals level be overseen by independent review panels
 - Establishing an accelerated appeals process for MSDs, such as loan reclassifications, that cause an institution to become critically undercapitalized
 - Including extensive provisions to protect banking organizations against retaliation by Federal Reserve staff for exercising the right to appeal, although uncertainty remains whether such provisions can ever be truly effective
- **The Supervision and Regulation Report issued in November 2018 confirmed the Federal Reserve’s continuing commitment to paradigmatic reform of transparency in examination and supervision.**
 - The Federal Reserve reiterated its commitment to reforming the examination appeals process.
 - The data included aggregate ratings and supervisory actions for banking organizations by type—large, foreign, community and regional—and revealed that the number of outstanding MRAs and MRIAs have generally decreased, except with respect to large foreign banking organizations (**FBOs**), which have seen MRAs and MRIAs increase due to regulatory changes that require changes to their U.S. structures.
 - Firms have improved in areas such as capital planning and liquidity management but continue to need improvement in risk management areas such as compliance, internal controls, model risk management, operational risk management and IT infrastructure.
 - Some firms continue to exhibit weaknesses in BSA/AML programs, which sometimes have longer remediation timelines.

For more information on the Federal Reserve’s proposal, please visit the [FinReg](#) blog – “[Legal Interpretations in Examination Appeals Should be More Transparent](#)” (Apr. 30, 2018).

Reform of Supervision

- **General Outlook:** A chorus of calls has grown within the Administration to rein in guidance and develop a theory of supervision to ensure that supervision is appropriately cabined within the bounds of due process and the rule of law.
- **Agency Perspectives:**
 - On September 11, 2018, the federal banking agencies [issued a statement](#) explaining that supervisory guidance does not have the force and effect of law and is not the basis of enforcement actions.
 - Federal Reserve Vice Chairman for Supervision Quarles has repeatedly emphasized the need for a theory of supervision.
 - During a [Yale School of Management Leaders Forum event](#) on May 7, 2019, in response to a question about the Federal Reserve’s role within the administrative state, supervision and regulation:
 - “I think that it is incumbent on the Federal Reserve and on financial regulatory agencies generally that have supervisory capacity—and those are mostly the bank regulatory agencies—to develop a very clear view ... really even a theory [about] what it is we mean by supervision and what we mean by regulation and what should be accomplished in which way.”
 - During [Senate Banking Committee testimony](#) on May 15, 2019, regarding the role of guidance:
 - “It’s incumbent on us at the Fed and all of us to think very carefully in a way that hasn’t been done in decades about where we are drawing the line between what can be accomplished through supervision and what types of things have to be accomplished through regulation ... and the due process requirements that apply to regulation under the Administrative Procedure Act. We have not done a very good job of that ... over the course of the last decade either at the Fed or, I think, the banking regulators generally.”

For more information on this topic, please visit the [FinReg](#) blog – [“Interagency Statement on Supervisory Guidance Could Result in Meaningful Changes to Supervisory Practices”](#) (Sept. 12, 2018).

Reform of Supervision

- **Other Administration Views:**

- On April 11, 2019, the Office of Management and Budget [issued a memorandum](#) reinforcing the obligations of federal agencies under the Congressional Review Act.
- On May 20, 2019, Principal Deputy Associate Attorney General Claire McCusker Murray [spoke](#) on DOJ efforts to rein in subregulatory guidance, distinguishing two categories of guidance: that mirroring what the law requires and everything else.
 - Murray explained that under our separation of powers “subregulatory guidance isn’t law—it’s just paper.”
- On April 30, 2019, Davis Polk partner Margaret E. Tahyar [testified](#) before the Senate Banking Committee on supervisory reform in the banking sector.
 - Ms. Tahyar’s testimony emphasized the need to limit and modernize the scope of confidential supervisory information, reform the activities of the banking agencies in favor of greater transparency and accountability and expand the training of supervisory staff to include core modules on the entire legal framework that governs the regulatory state.

For more information on this topic, please visit the [FinReg](#) blog – [“A Tale of Two Guidances – New Principal Deputy Associate Attorney General Claire McCusker Murray Speaks on DOJ Efforts to Rein in Subregulatory Guidance”](#) (May 23, 2019).

Agency Deference

- **General Outlook:** Potential changes to the level of deference courts are required to give to agency interpretations are on the horizon.
- **Chevron Deference:**
 - Under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, courts must defer to an agency's interpretation of ambiguous statutory language, provided that interpretation is reasonable.
 - Following recent changes in the composition of the Supreme Court, including the appointments of Justices Kavanaugh and Gorsuch, the future of *Chevron* deference has been called into question.
- **Auer Deference:**
 - The Supreme Court heard oral arguments in *Kisor v. Wilkie* on March 27, 2019.
 - In *Kisor*, the Court has been asked to decide whether to overrule *Auer v. Robbins* and *Bowles v. Seminole Rock & Sand Co.*, which direct courts to defer to an agency's reasonable interpretation of its own ambiguous regulation.
 - A decision is expected by June 2019.

For more information on Justices Gorsuch and Kavanaugh's views on Chevron deference, please see the Davis Polk Client Memoranda – [“U.S. Supreme Court Confirmation of Justice Neil Gorsuch and Potential Future Impacts on Environmental Laws and Regulations”](#) (Apr. 11, 2017) and [“What Would a U.S. Supreme Court Confirmation of Judge Kavanaugh Mean for Environmental Regulation?”](#) (Sept. 7, 2018).

CFPB: Constitutional Challenges

- **General Outlook:** Appeals challenging the constitutionality of the CFPB's structure are pending in the Second and Fifth Circuits. We believe a circuit split on the constitutionality of the CFPB's structure, followed by Supreme Court review when a proper vehicle arises, is increasingly likely.
- **Judicial Developments:**
 - On May 6, 2019, a three judge panel of the Ninth Circuit in *CFPB v. Seila Law LLC* upheld the constitutionality of the CFPB's structure, drawing heavily on the reasoning of the majority opinion of the D.C. Circuit, sitting *en banc*, in *PHH v. CFPB* and seeing “no need to re-plow the same ground.” In doing so, the Ninth Circuit affirmed the district court's order directing Seila Law to comply with a civil investigative demand seeking information as part of an investigation concerning a consumer debt relief scheme.
 - In June 2018, Senior United States District Judge Preska of the Second District of New York found the CFPB's structure unconstitutional in *CFPB v. RD Legal Funding*, a case arising from joint enforcement actions brought by the CFPB and the New York Attorney General (**NYAG**).
 - In disagreement with the majority opinion of the D.C. Circuit in *PHH*, Judge Preska adopted much of the dissent of Judge Kavanaugh, then a D.C. Circuit judge and now a Supreme Court Justice, in *PHH* to find that the structure of the CFPB—an agency headed by a single director, removable by the President only for “inefficiency, neglect of duty or malfeasance in office”—is unconstitutional. In contrast to Judge Kavanaugh's dissent, Judge Preska found that the specific unconstitutional provision is not severable from the remainder of Title X of the Dodd-Frank Act, and therefore determined that the entirety of Title X must be struck down.
 - In separate appellate briefs filed on March 15, 2019, the CFPB and NYAG both argue that the CFPB's structure is constitutional under controlling Supreme Court precedent and that, in any event, the for cause removal provision challenged as unconstitutional is severable from the rest of the Title X provisions establishing the CFPB.

For more information on the CFPB litigation, please visit the [FinReg](#) blog – “[SDNY Weighs In on the Constitutionality of the CFPB's Structure](#)” (June 22, 2018).

CFPB: Constitutional Challenges

- On March 19, 2019, the Fifth Circuit heard oral argument on the constitutionality of the CFPB's structure. In *CFPB v. All American Check Cashing, Inc.*, the CFPB brought an enforcement action against All American in the Southern District of Mississippi. On March 21, 2018, United States District Judge Barbour denied All American's motion for judgment on the pleadings, relying on *PHH* in rejecting All American's argument that the CFPB is unconstitutionally structured.
- We also note the July 2018 Fifth Circuit per curiam decision in *Collins v. Mnuchin*, which included a claim that the FHFA is "unconstitutionally structured because . . . it is headed by a single Director removable only for cause." In finding that the FHFA is unconstitutionally structured, the Fifth Circuit stated that agencies "may be independent, but they may not be isolated," that courts "must look at the aggregate effect of the insulating mechanisms," and repeatedly cited the dissents of Judges Kavanaugh and Henderson in *PHH*. The Fifth Circuit heard oral arguments in an *en banc* hearing on January 23, 2019. The FHFA, under new Acting Director Joseph Otting, has indicated that it no longer defends the constitutionality of the for-cause removal protection of FHFA directors.

For more information on the FHFA litigation, please visit the [FinReg](#) blog – "[Fifth Circuit Holds That FHFA is Unconstitutionally Structured](#)" (July 18, 2018).

GSE Reform

- **General Outlook:** Perhaps, finally, momentum may be building toward serious attempts at reform of the government-sponsored enterprises (**GSEs**). Targeted administrative changes seem more probable than wholesale legislative reform, particularly in light of the upcoming election, and newly confirmed Federal Housing Finance Agency (**FHFA**) Director Calabria is pursuing a determined agenda to end the conservatorships with or without Congressional action.
 - On March 27, 2019, President Trump issued a presidential memorandum directing the Treasury Secretary and the Housing and Urban Development Secretary each to develop a plan for legislative and administrative reforms to the housing finance system with the goal of ending the GSE conservatorships. Director Calabria said in an interview on April 22, 2019, that he anticipates this plan will be completed by June.
 - Director Calabria declared in a speech on May 20, 2019, that the GSE “status quo is over.” Although he has noted that he will be a “vocal advocate for Congressional action,” he also stated in a speech on May 14 that the FHFA has statutory authority to end the conservatorships of the GSEs.
- **Potential Methods of Change:**
 - **Legislative:** In March 2019, the Senate Banking Committee held hearings on housing finance reform and heard testimony on Sen. Crapo’s outline of legislation to end the conservatorship of the GSEs.
 - Sen. Crapo’s framework would, among other things, convert Fannie Mae and Freddie Mac into private guarantors, assign responsibility for providing a catastrophic backstop to Ginnie Mae, and allow other guarantors to enter the market.
 - **Administrative**
 - The FHFA could reduce the GSEs’ footprint by, for example, lowering the share of loans that qualify for GSE support and/or changing credit requirements.
 - In addition, Treasury and the FHFA could agree to stop the net worth sweep or otherwise make arrangements, including through public markets, to allow the GSEs to rebuild capital. Director Calabria stated in an interview on May 17, 2019, that raising sufficient capital is the first step toward ending the GSE conservatorships.

Tailored Regulation

- **General Outlook:** EGRRCPA requires regulation and supervision to be tailored to a banking organization's business model and risk profile by raising asset size thresholds for many requirements.
 - EGRRCPA raised the statutory thresholds, generally from \$50 billion to \$250 billion in total consolidated assets, for many of the Federal Reserve's EPS, including resolution planning and single-counterparty credit limits (**SCCL**).
 - The Federal Reserve released proposed rules in October 2018 to tailor EPS for U.S. firms above \$100 billion in assets, and the U.S. banking agencies proposed corresponding tailoring changes to their capital and liquidity rules. [See our visual memorandum here for a detailed analysis of the Federal Reserve's proposed rules.](#)
 - In April 2019, the U.S. banking agencies released similar proposals to tailor EPS and capital and liquidity rules for FBOs and their U.S. IHCs. For more detail on the specifics of this FBO tailoring proposal, see the Foreign Banking Organizations slides.
 - According to the [Spring 2019 Unified Agenda of Regulatory and Deregulatory Actions](#) (**Spring Regulatory Agenda**), the Federal Reserve expects to finalize the tailoring proposed rules in August 2019. It is not clear whether this timeline applies only to the proposals for U.S. firms or also to the proposals for FBOs and their U.S. IHCs.
 - Under the proposed rules, the requirements applicable to a firm would depend on which of the following Categories the firm falls into:
 - **Category I** – U.S. G-SIB
 - **Category II** – Either:
 - ≥ \$700 billion in assets; or
 - ≥ \$75 billion in cross-jurisdictional activity
 - **Category III** – Either:
 - ≥ \$250 billion in assets; or
 - ≥ \$75 billion in one of nonbank assets, weighted short-term wholesale funding or off-balance sheet exposures
 - **Category IV** – Any other firm with ≥ \$100 billion in assets

Tailored Regulation

- The proposed rules would also apply EPS to certain non-insurance SLHCs that qualify as a Category I, II, III or IV firm.
 - Currently, covered SLHCs are subject to regulatory capital requirements and the LCR but are not subject to capital planning, supervisory DFAST and other EPS requirements applicable to similarly sized BHCs.
- Still to come are proposed tailoring changes to the capital planning rule.
- In Rep. Waters’ November 9, 2018 letter, she noted that “Democrats are [also] concerned about preserving small community financial institutions,” signaling that regulatory tailoring for community banks and credit unions could continue in 2019.
- For more detail on the targeted relief to capital and liquidity regulations provided by EGRRCPA, see the Capital and Stress Testing and Liquidity slides.
- For more detail on the Federal Reserve’s and FDIC’s proposal to tailor resolution planning requirements for U.S. and non-U.S. firms, see the Living Wills slides.
- See our visual memorandum [here](#) describing the key changes EGRRCPA makes to the regulation of banking organizations—color coded for those who want to look only at the changes that affect their own organization.

Tailored Regulation

The following chart summarizes the state of play under the tailoring proposed rules regarding asset-based regulatory thresholds applicable to U.S. BHCs and covered SLHCs that fall into the categories defined in the previous page:

	U.S. Category IV Firm	U.S. Category III Firm	U.S. Category II Firm	Category I – U.S. GSIB
TLAC requirement				✓
GSIB surcharge				✓
Enhanced SLR				✓
Advanced approaches risk weights			✓	✓
AOCI recognized in capital			✓	✓
CCyB (if deployed)		✓	✓	✓
SLR		✓	✓	✓
Company-run DFAST		Every two years ¹	Annual	Annual
SCCL		✓ ²	✓ ²	✓
Qualitative CCAR		✓	✓	✓
LCR	Reduced / Exempt ³	Full / Reduced ⁴	Full	Full
Proposed NSFR	Reduced / Exempt ³	Full / Reduced ⁴	Full	Full
Proposed stress buffer requirements	✓ ⁵	✓	✓	✓
Quantitative CCAR	Streamlined annual ⁵	Annual	Annual	Annual
Supervisory DFAST	Every two years	Annual	Annual	Annual
Internal liquidity stress testing	Quarterly	Monthly	Monthly	Monthly
Liquidity risk management	Slightly tailored	✓	✓	✓
Risk committee and risk management	✓	✓	✓	✓

1. A U.S. Category III firm would be required to submit internal stress test results to the Federal Reserve as part of its annual capital plan submission, but would be required to publicly disclose its company-run DFAST results only once every two years.

2. A U.S. Category II or III firm's aggregate net credit exposure to a single counterparty would be capped at 25% of tier 1 capital, which currently applies under the Federal Reserve's SCCL rule to U.S. BHCs that are not GSIBs and have ≥ \$250B of total consolidated assets.

3. A reduced monthly LCR and NSFR of between 70 and 85% of the relevant full requirement would apply to a U.S. Category IV firm with ≥ \$50B of weighted STWF.

4. A reduced daily LCR and NSFR of between 70 and 85% of the relevant full requirement would apply to a U.S. Category III firm with < \$75B of weighted STWF.

5. The Federal Reserve stated that its final stress buffer requirements rule and a forthcoming capital planning proposal will require a Category IV firm to submit a streamlined annual capital plan, but that the stress loss portion of a Category IV firm's stress buffer requirements would be updated every two years (to align with the two-year supervisory DFAST cycle for Category IV firms), whereas the planned distributions portion of the stress buffer requirements would be updated annually (based on the firm's annual capital plan).

Tailored Regulation

- **Federal Agencies Have Also Been Tailoring Other Regulations:**
 - In December 2018, the OCC revised its recovery planning guidance to raise the asset threshold at which national banks, federal savings associations and federal branches of FBOs become subject to the OCC's recovery planning requirements from \$50 billion to \$250 billion in average total consolidated assets.
 - The U.S. banking agencies have also proposed or finalized rules to tailor certain aspects of their capital and stress testing rules to banking organizations' size and operations, as described in more detail in the Capital and Stress Testing slides.
 - See the Foreign Banking Organizations slides for a discussion of tailoring applicable to those entities.

Capital and Stress Testing

- **General Outlook:** U.S. banking agencies have unfinished business in implementing or finalizing U.S. Basel III capital and liquidity requirements. Chairman Powell and Vice Chairman for Supervision Quarles have signaled that the intention is not to weaken capital, liquidity or stress-testing requirements, but to strengthen and improve them by making them more transparent, efficient and simple. In a May 2019 letter, a number of House Republicans urged the banking regulators to speed implementation of certain recommendations in the Treasury Reports, while several House Democrats wrote to Chairman Powell and Vice Chairman for Supervision Quarles, also in May 2019, disapproving of “recent deregulatory moves... that seem to ignore lessons from the 2008 financial crisis.”
 - **Capital:**
 - Simplification of Capital Rules for Non-Advanced Approaches Firms – proposed September 2017 (see slide 17)
 - Implementation of Stress Buffer Requirements (**SBR**) – proposed April 2018 (see slides 23 – 24)
 - Recalibration of enhanced SLR (**eSLR**) – proposed April 2018 (see slide 25)
 - Standardized Approach for Counterparty Credit Risk (**SA-CCR**) – proposed October 2018 (see slide 26)
 - Vice Chairman for Supervision Quarles has stated that the Federal Reserve is “actively” looking at the G-SIB surcharge “within [the context of] all capital regulation,” including capital standards that have yet to be implemented.
 - **Stress Testing and Capital Planning (DFAST and CCAR):**
 - In February 2019, the Federal Reserve issued an amended policy statement on the scenario design framework for supervisory stress testing aimed at increasing the transparency of its stress testing (**DFAST**) and capital planning (**CCAR**) requirements. In March 2019, the Federal Reserve disclosed significantly more information on the models used to project bank losses than was disclosed in prior years. The additional information includes ranges of loss rates, portfolios of hypothetical loans with loss rates projected by the Federal Reserve’s models, and enhanced description of the models. The Federal Reserve is considering whether to publish its supervisory scenarios for comment.
 - In March 2019, the Federal Reserve issued a final rule that eliminates the CCAR qualitative objection for U.S. G-SIBs and all but five FBOs, and will phase out the CCAR qualitative objection for those five FBOs. In addition, the 2019 CCAR instructions excused all but 18 firms from the 2019 CCAR exercise.
 - The SBR proposal would also change certain CCAR and DFAST assumptions that could otherwise result in excessive stressed capital requirements for banking organizations that are subject to DFAST and CCAR (see slide 23).

For more information on the revised G-SIB assessment methodology, visit the [FinReg](#) blog – “[Basel Committee Publishes Revised Assessment Methodology for GSIBs](#)” (July 6, 2018).

Capital and Stress Testing

- **Simplification of Capital Rules for Non-Advanced Approaches Firms:** In September 2017, the U.S. banking agencies proposed simplifying certain aspects of their Basel III capital rules and making some technical corrections to them. According to the Spring Regulatory Agenda, the agencies expect further action on the proposed rules in June 2019. The simplification proposals would affect non-advanced approaches banking organizations and would result in the following changes:
 - **Simplified Treatment of Threshold Deduction Items:** For mortgage servicing assets (**MSAs**), temporary difference deferred tax assets (**DTAs**), and significant investments in unconsolidated financial institutions, the proposal would:
 - Replace the 10% of CET 1 capital deduction thresholds for each category with 25% of CET 1 capital thresholds
 - Eliminate the aggregate 15% of CET 1 threshold for the combined impact of the three categories of deduction items
 - Eliminate the distinction between significant and non-significant investments in unconsolidated financial institutions and treat all investments in unconsolidated financial institutions as subject to a single 25% of CET 1 capital threshold
 - Risk weight MSAs and temporary difference DTAs that are not deducted from CET 1 capital at 250%
 - Risk weight investments in the capital of unconsolidated financial institutions that are not deducted from CET 1 capital according to the relevant treatment of the exposure under the capital rules (i.e., for equity exposures, ranging from 100% for non-significant equity exposures to 300% or 400% for publicly traded and non-publicly traded equity exposures, respectively)
 - **Simplified Treatment of Minority Interests:** The proposal would:
 - Permit the recognition of minority interests issued by consolidated subsidiaries up to 10% of the relevant tier of capital after all other deductions and adjustments, but before recognition of minority interests (i.e., up to 10% of the firm's CET 1 capital for CET 1 capital instruments issued by the subsidiary to third parties, up to 10% of the firm's Tier 1 capital for Tier 1 capital instruments issued by the subsidiary to third parties, etc.)
 - Eliminate the restriction on the recognition of a subsidiary's surplus capital attributable to minority interests

Capital and Stress Testing

- **Delay in Final Phase-in of Capital Rules for Non-Advanced Approaches Firms:** In November 2017, in keeping with the capital simplification proposal, the U.S. banking agencies finalized a rule to indefinitely delay, for non-advanced approaches banking organizations, the final phase-in step of the transition provisions of the capital rules that would be affected by the proposal.

Capital Standards Finalized by Basel Committee but Not Yet Implemented in the United States

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| <ul style="list-style-type: none"> • Fundamental Review of the Trading Book (FRTB) • Interest Rate Risk in Banking Book (IRBB) • Revised Securitization Framework • Revised Treatment of Investment Funds • Standardized Measure for Operational Risk | <ul style="list-style-type: none"> • Basel Committee released finalized revisions to the Basel III capital standards in December 2017 • Revised assessment methodology published for G-SIBs • Capital Floors for Credit Risk <ul style="list-style-type: none"> • Unclear how the Basel Committee capital floor standard will be implemented in the United States in light of the Collins Amendment, which effectively imposes 100% of standardized RWAs as a floor |
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- **Statutory Developments:** EGRRCPA makes the following changes to the **U.S. Basel III capital rules**:
 - **SLR for Custody Banks:** EGRRCPA directs the U.S. banking agencies to exclude certain central bank deposits from the total leverage exposure (the SLR denominator) of custody banks, defined as “depository institution holding companies predominantly engaged in custody, safekeeping and asset servicing activities,” together with their insured depository institution subsidiaries. In March and April 2019, the banking agencies released a joint proposed rulemaking to implement this provision of the law.
 - Under the proposal, custody banks would exclude from total leverage exposure the lesser of (1) the total amount of the bank’s cash on deposit with a qualifying central bank, and (2) the total amount of the bank’s deposit liabilities held in customer deposit accounts that, in each case, are linked to the customer’s fiduciary or custodial and safekeeping accounts.
 - The proposed rule defines custody bank such that only three U.S. BHCs, and their bank subsidiaries, would benefit from the exclusion.

For more information, visit the [FinReg](#) blog – “[U.S. Banking Agencies Propose Custody Bank Relief under the Supplementary Leverage Ratio](#)” (Apr. 23, 2019).

Capital and Stress Testing

- **Community Bank Leverage Ratio:** EGRRCPA directs the U.S. banking agencies to establish via rulemaking a community bank leverage ratio, and community banking organizations that meet this leverage ratio will be deemed to have met their applicable leverage ratios, risk-based capital ratios, well-capitalized minimums for prompt corrective action and any other applicable capital or leverage requirements.
- On February 8, 2019, the U.S. banking agencies [proposed a rule](#) that would simplify capital requirements for qualifying community banks by providing a community bank leverage ratio (**CBLR**) as an optional alternative to the U.S. Basel III capital rules. According to the Spring Regulatory Agenda, the agencies expect further action on the proposed rule in August 2019.
 - Available for qualifying community banking organizations:
 - < \$10 billion in total consolidated assets
 - Off-balance sheet exposures, excluding derivatives other than credit derivatives and unconditionally cancelable commitments, $\leq 25\%$ of total consolidated assets
 - Trading assets / liabilities $\leq 5\%$ of total consolidated assets
 - MSAs $\leq 25\%$ of CBLR tangible equity
 - Temporary difference DTAs $\leq 25\%$ of CBLR tangible equity
 - Minimum CBLR of 9% (tangible equity / average total consolidated assets)
 - Deemed to meet generally applicable U.S. Basel III capital requirements
 - Well-capitalized for prompt corrective action purposes
 - Simpler measure than U.S. Basel III risk-based capital calculations; additional qualifying capital instruments
 - Risk-insensitive because exposures are not risk-weighted

Capital and Stress Testing

- **Capital Treatment of Commercial Real Estate Exposures:**

- On September 18, 2018, the U.S. banking agencies [proposed a rule](#) that would substantively replace the current definition of a High Volatility Commercial Real Estate (**HVCRE**) exposure in the capital rules with EGRRCPA's definition of a high volatility commercial real estate acquisition, development, or construction (**HVCRE ADC**) loan. According to the Spring Regulatory Agenda, the agencies expect further action on the proposed rule in May 2019. This proposed rule would:
 - Provide a narrower definition of HVCRE exposures that must be risk weighted at 150% under the standardized approach
 - Only HVCRE ADC loans qualify for 150% risk weighting
 - Must “primarily” finance or refinance acquisition, development or construction of real property
 - Must have purpose of providing finance to acquire, develop or improve real property into income-producing property
 - Must be dependent on future income or sales proceeds from, or refinancing of, real property for repayment
 - Exempt projects meeting applicable maximum loan-to-value ratios and for which the borrower has contributed capital of at least 15% of the real property's “as completed” value for the life of the project
 - Appreciation in value of real property at time of contribution may be included in 15% contributed capital requirement
 - No restriction on distributing capital contributed in excess of 15% requirement
 - Exempt any loan made prior to January 1, 2015 – the date the original heightened risk weight for HVCRE exposures went into effect – from the new definition of an HVCRE exposure, as required by EGRRCPA
 - Apply the general 100% risk weight to non-HVCRE exposures, unless another lower or higher risk weight otherwise applies

Capital and Stress Testing

- Until this rule is finalized, the U.S. banking agencies' interagency statement announcing their interim position regarding EGRRCPA continues to apply. Under this interim position, banking organizations may either:
 - Risk weight at 150% only those exposures it believes meet the statutory definition of an HVCRE ADC loan, or
 - Continue to risk weight HVCRE exposures at 150% to the extent they meet the current regulatory definition
- EGRRCPA and the related tailoring proposal include the following changes to the **DFAST stress testing requirements**:
 - **Thresholds and Frequency of DFAST Company-Run Stress Tests:**
 - The Federal Reserve and other U.S. banking agencies have proposed rules that would tailor company-run and supervisory DFAST requirements for G-SIBs, BHCs, SLHCs and U.S. IHCs of FBOs based on the Category into which each firm falls:

	Category IV	Category III	Category II	Category I
Company-Run DFAST	Exempt	Every 2 years	Annual	Annual
Supervisory DFAST	Every 2 years	Annual	Annual	Annual

See slide 12 in the Tailored Regulation section above for a description of Categories I through IV, slide 14 for a table describing the impact of the proposals on institutions in each of the categories and slides 34 – 36 for tables describing the impact of the proposals on FBOs and their U.S. IHCs. According to the Spring Regulatory Agenda, the agencies expect to finalize the proposed rules in August 2019.

- Although a Category III firm would be required to publicly disclose the results of its DFAST company-run stress tests only once every two years, it would still be required to submit internal stress test results annually to the Federal Reserve as part of its capital plan submission.

For more information on the revised G-SIB assessment methodology, visit the [FinReg](#) blog – “[Federal Banking Regulators Propose EGRRCPA-Conforming Amendments to Stress Testing Rules](#)” (Jan. 22, 2019).

Capital and Stress Testing

- The U.S. banking agencies have also proposed changes to company-run DFAST requirements for banks and savings associations to:
 - Apply only to institutions with \geq \$250 billion in assets
 - Occur only every two years, beginning in 2020, unless the institution's parent holding company is required to conduct annual company-run stress tests
- EGRRCPA changes to the DFAST and CCAR requirements also include:
 - **Number of Dodd-Frank Act Stress Test Economic Scenarios:** EGRRCPA also reduces the required number of economic scenarios from three to two, eliminating the adverse scenario and leaving the baseline and severely adverse scenarios.
 - **Timing of CCAR and DFAST Threshold Changes:**
 - On October 31, 2018, the Federal Reserve and other U.S. banking agencies issued proposed rules that would adjust the thresholds applicable to BHCs' company-run and supervisory DFAST requirements.
 - BHCs with $<$ \$100 billion in total consolidated assets are exempt from both DFAST and CCAR for the 2019 cycle, as expected.
 - The proposed rules would remove the mid-cycle company-run stress test for all BHCs, including G-SIBs, effective in the 2020 cycle.
 - The proposed rules also stated that Federal Reserve and U.S. banking agencies, as appropriate, will issue proposed rules to align CCAR requirements for BHCs and company-run DFAST requirements for non-BHC companies, including banks, in the future.

Capital and Stress Testing

- **Other Potential Methods of Change:**

- **Stress Buffer Requirements:** In April 2018, the Federal Reserve released a proposed rule on the implementation of the SBR that would fundamentally change how stress testing is used to impose capital requirements for large BHCs.
 - The SBR proposal would eliminate the ability of the Federal Reserve to object to a capital plan on quantitative grounds, and instead incorporate stress losses directly into a firm's point-in-time capital requirements by replacing the 2.5% fixed portion of the capital conservation buffer with a new stress capital buffer (**SCB**) equal to a firm's peak-to-trough stress losses, on top of the G-SIB surcharge and any applicable countercyclical capital buffer.
 - The SBR proposal would incorporate four quarters of planned dividends based on a firm's baseline projections to the calibration of the SCB.
 - The SBR proposal would also modify several assumptions in the CCAR framework to better align them with a firm's expected actions under stress, including a constant rather than growing balance sheet.
 - According to the Spring Regulatory Agenda, the Federal Reserve expects further action on the proposed rule in August 2019.
- **Modifications Coming**
 - As proposed, the SBR proposal would have been effective in time for the 2019 CCAR and DFAST cycle. In a November 2018 speech at the Brookings Institution, however, Vice Chairman for Supervision Quarles said that the SBR proposal would be modified in response to "extensive and thoughtful" comments and delayed past the start of the 2019 CCAR and DFAST cycle.
 - Quarles stated that his foremost concern is the volatility of stress test results. He emphasized the need to strike a balance between ensuring that firms have sufficient notice of changes in their capital requirements and preserving the supervisory ability to adapt the stress tests to changing macroeconomic conditions and an evolving understanding of the salient risks.

For more information on SBR, please visit the [FinReg](#) blog – "[Federal Reserve Proposes Stress Capital Buffer Requirements in Overhaul of CCAR](#)" (Apr. 17, 2018); for further information on banking sector responses to the April 2018 proposal, see the comment letters submitted by the [ABA](#), the [IIB](#), and [TCH, SIFMA, the FSR and ISDA](#) (June 25, 2018).

Capital and Stress Testing

- Quarles also previewed other modifications to the SBR proposal, including:
 - Modifying the market shock framework applicable to the six firms with the most significant trading activity to utilize more stress scenarios, rather than a single stress scenario;
 - Modifying the timing of the requirement to submit final capital distribution plans relative to the release of the supervisory stress test results, including the annual recalibration of firms' SCB requirements;
 - Alternatives to the dividend add-on component of the SCB calibration; and
 - Eliminating the stress leverage buffer so that risk-insensitive leverage requirements serve as a back-stop to risk-based requirements, as intended.
- **Multi-Step Approach:**
 - Quarles stated that the SBR would be finalized in two steps:
 - First, a final rule implementing “the basic framework” of the SCB
 - Second, a re-proposal of “certain elements” of the SBR proposal, with these elements to be finalized at a later date
 - Based on this timing, the first SCB would become effective starting with the 2020 CCAR and DFAST cycle.
- **Stop-Gap Modifications to 2019 CCAR and DFAST:** Quarles also stated that he would seek to modify certain elements of the 2019 CCAR quantitative assessment, given the delay in finalizing the SBR proposal and the pending proposed rules to tailor EPS in accordance with EGRRCPPA.
 - In February 2019, the Federal Reserve announced that less-complex firms (assets \geq \$100 < 250 billion) would not be subject to stress testing during the 2019 cycle and that their capital distributions for this year will be based on the results from the 2018 stress tests.
- In March 2019, the Federal Reserve announced that it would limit the use of the “qualitative objection” in the 2019 CCAR cycle.

Capital and Stress Testing

- **Recalibration of Enhanced SLR:** In April 2018, the Federal Reserve and OCC released a proposed rule on the recalibration of eSLR that would recalibrate and tailor leverage ratio requirements for U.S. G-SIBs by tying the eSLR buffer requirement to the risk-based G-SIB capital surcharge of each firm.
 - At the holding company level, the proposed rule would change the eSLR buffer from a fixed 2% to one half of each firm's G-SIB surcharge.
 - For the insured depository institution subsidiaries of G-SIBs that have the Federal Reserve or OCC as their primary federal regulator, the proposal would similarly change the current 6% "well capitalized" standard to 3% plus one half of the parent's G-SIB surcharge.
 - These changes correspond to changes to the Basel III rules proposed by the Basel Committee on Banking Supervision.
 - The proposal would also make corresponding changes to the calibration of the SLR components of the Total Loss Absorbing Capacity (**TLAC**) and long-term debt requirements for U.S. G-SIBs and invited comment on whether to recalibrate the TLAC SLR and long-term debt SLR to reflect more closely the capital refill framework and to more closely align the U.S. rules with international standards.
 - Vice Chairman for Supervision Quarles stated in his April 2018 testimony to the House Financial Services Committee that the objective of the eSLR calibration is to make sure that the eSLR is not a primary binding capital measure.
 - Quarles also stated that in that testimony that it would be appropriate to reconsider the proposed recalibration of the eSLR "to take account of the fact that certain [custody] banks would have had the denominator of the eSLR changed for them" under Section 402 of the EGRRCPPA, which directs the U.S. banking agencies to exclude certain central bank deposits from the SLR denominator for certain custody banks.

For more information on eSLR, please visit the [FinReg](#) blog – "[Federal Reserve and OCC Propose Tailoring of Enhanced Supplementary Leverage Ratios for GSIBs and their IDIs](#)" (Apr. 17, 2018).

Capital and Stress Testing

- **SA-CCR:** In October 2018, the Federal Reserve, the FDIC and the OCC released a joint proposed rule that would implement the standardized approach for counterparty credit risk (**SA-CCR**), a new standardized methodology for calculating the exposure amount for derivative contracts under the U.S. Basel III capital rules. The new SA-CCR methodology under the proposal would generally track the Basel Committee's version of SA-CCR finalized in 2014, which reflects a more risk sensitive approach than the existing current exposure method (**CEM**). According to the Spring Regulatory Agenda, the agencies expect further action on the proposed rule in August 2019.
 - The proposal would require advanced approaches banking organizations to use SA-CCR to measure counterparty credit risk for derivatives, in lieu of CEM.
 - The proposal would permit non-advanced approaches banking organizations to use either SA-CCR or CEM to measure counterparty credit risk for derivatives.
 - The proposal would also make conforming changes incorporating the new SA-CCR methodology to other requirements related to derivative exposures, such as determining exposure amounts for cleared derivatives, calculating the risk-weighted asset amount for default fund contributions to CCPs, and measurements of off-balance sheet exposures related to derivatives under the SLR.
 - The proposal would also indirectly affect the measurement of exposure concentrations for purposes of the SCCL requirements.
 - The Commissioners of the CFTC released a comment letter on the proposed rule, arguing that without revisions to the proposed SA-CCR rule, clearing members will continue to limit the provisions of clearing services or exit the clearing business, causing the worrisome trend of clearing member consolidation to continue.
- See slides 31 – 32 for a discussion of CECL.

Capital and Stress Testing

- **CCyB:** In March 2019, Vice Chairman for Supervision Quarles spoke approvingly of the U.K.’s implementation of the countercyclical capital buffer (**CCyB**). While the Federal Reserve has maintained the CCyB at zero since its introduction in 2016, the U.K. Financial Policy Committee has set the CCyB to one percent in normal conditions, offset by a one-time reduction of its other capital buffers. This framework provides U.K. authorities with the flexibility to either increase or decrease the CCyB from a one-percent baseline based on prevailing economic conditions, while maintaining overall capital requirements at appropriate levels under normal conditions.
- **TLAC Holdings Proposal:** In April 2019, the agencies issued a proposed rule that would require advanced approaches banking organizations to make deductions from their regulatory capital for a portion of their investments in certain debt instruments issued by globally systemically important BHCs, IHCs covered under the TLAC rule and foreign G-SIBs or any of their subsidiaries (other than a covered IHC), in order to limit interconnectedness and potential contagion risk. The proposal includes a limited exception for certain market-making activities.
- **G-SIB Surcharge Recalibration:** As noted throughout this section, there are several significant changes to the capital framework that are still in progress, including finalizing the SCB and SA-CCR proposals, implementing the BCBS’s Basel III finalization and FRTB standards, and potential changes to the CCyB framework. Vice Chairman for Supervision Quarles stated in his May 2019 testimony before the House Financial Services Committee that he is looking at the G-SIB Surcharge “comprehensively”, and that he is being careful not to amend one aspect of the capital regime only to find it was set too high given a different capital standard that is later implemented.

Liquidity

- **General Outlook:**

- **Net Stable Funding Ratio (NSFR)** – proposed June 2016; According to the Spring Regulatory Agenda, the agencies expect further action on the proposed rule in September 2019.

- **Statutory Developments:** EGRRCPA makes the following changes to the **U.S. Basel III liquidity rules:**

- **Treatment of Municipal Securities under the LCR:** As required by EGRRCPA, the U.S. banking agencies on May 30, 2019 issued a final rule amending the LCR to expand the eligibility of investment grade municipal obligations as Level 2B high-quality liquid assets.

For more information on this topic, please visit the [FinReg](#) blog – “[Federal Banking Agencies Relax LCR Treatment of Municipal Bonds in Line with EGRRCPA](#)” (Aug. 23, 2018).

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

TLAC

- **General Outlook:** The Federal Reserve has expressed interest in streamlining parts of the TLAC requirements and some adjustments are likely.
- **Potential Methods of Change:**
 - In Vice Chairman for Supervision Quarles' January 2018 speech to the ABA Banking Law Committee, he stated that the Federal Reserve was considering simplifying its TLAC rule. Federal Reserve staff later stated that the Federal Reserve is going to take a “fresh look” at the TLAC rule.
 - Vice Chairman for Supervision Quarles' May 2018 remarks at Harvard proposed a “trust everyone, but brand your cattle” approach to internal TLAC, with host jurisdictions supporting SPOE resolution globally by moderating demand on global banks to pre-position internal TLAC and corresponding assets locally.
 - To this end, Vice Chairman for Supervision Quarles further stated in his May 2018 speech, as supplemented by a post-speech Q&A, that the Federal Reserve was considering, among other things:
 - Reducing its internal TLAC requirements applicable to the U.S. IHCs of foreign G-SIBs from 90% to 75% of external TLAC, perhaps on a reciprocal basis with host jurisdictions of the non-U.S. operations of U.S. G-SIBs
 - Eliminating its separate long-term debt requirement
 - The Treasury Banking Report recommends recalibrating internal TLAC requirements for U.S. IHCs by considering the foreign parent's ability to provide capital and liquidity resources to the U.S. IHC, provided arrangements are made with home country supervisors for deploying unallocated TLAC from the parent, among other factors.

For more information on TLAC, please visit the [FinReg](#) blog – [“Federal Reserve May Simplify the TLAC Rule”](#) (Jan. 30, 2018).

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

TLAC

- The Federal Reserve’s and OCC’s April 2018 proposal on the recalibration of eSLR would also make changes to the calibration of the SLR components of the TLAC and long-term debt requirements for U.S. G-SIBs, and invited comment on whether to recalibrate the TLAC SLR and long-term debt SLR to reflect more closely the capital refill framework and to more closely align the U.S. rules with international standards.
- The Treasury Department’s December 2018 proposed regulations on the Base Erosion and Anti-Abuse Tax (**BEAT**) would create an exception from base erosion payment status for interest paid or accrued on internal TLAC securities issued by IHCs of non-U.S. G-SIBs as required under the Federal Reserve’s TLAC rule.
- The FDIC, Federal Reserve and OCC issued a joint proposal in April 2019 that would require advanced approaches banking organizations to deduct from their regulatory capital certain investments in unsecured debt instruments that were issued by G-SIBs for the purpose of meeting TLAC and long-term debt requirements or that are *pari passu* or subordinated to such instruments. The proposal would also require the U.S. G-SIBs and U.S IHCs of foreign G-SIBs that are subject to the TLAC rule to publicly disclose their long-term debt and TLAC.

For more information on TLAC, please visit the [FinReg](#) blog – “[Federal Reserve May Simplify the TLAC Rule](#)” (Jan. 30, 2018).

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

CECL

- **General Outlook:** The Current Expected Credit Losses methodology accounting standard (**CECL**), will become effective for SEC-reporting companies for fiscal years beginning after December 15, 2019, but the financial sector and members of Congress on both sides of the aisle are calling for implementation to be delayed.
- **CECL Overview:** The CECL accounting standard applies to all banks, savings associations, credit unions and financial institution holding companies, regardless of size, that file reports for which the reporting requirements conform to U.S. GAAP.
 - CECL will generally accelerate the recognition of credit losses because it requires recognition of lifetime expected credit losses for financial assets measured at amortized cost upon originating or acquiring the asset.
 - Upon adopting CECL, companies will record a one-time adjustment to credit loss allowances at the beginning of the applicable fiscal year.
- **Regulatory Developments:**
 - The Federal Reserve, FDIC, OCC and NCUA updated their FAQs on the adoption of CECL in April 2019. The FAQs cover various technical aspects regarding implementing CECL. Among other updates, the FAQs now clarify that institutions may leverage stress testing models for CECL implementation, but such models should be adjusted accordingly. In addition, the agencies specified that institutions should not rely on the Federal Reserve's baseline economic scenario for stress testing to forecast economic conditions for CECL models.
 - The Federal Reserve, FDIC and OCC adopted a final rule that provides BHCs and banks with the option to phase-in the Day 1 adverse regulatory capital effects of CECL over a period of three years. The final rule became effective April 1, 2019, and banking organizations that chose to adopt early CECL could elect to adopt the final rule as of the first quarter 2019.
 - The rule is intended to mitigate any adverse impact of CECL on regulatory capital, including:
 - Reduction in earnings or retained earnings
 - Increases in temporary difference DTAs that are included in risk-weighted assets or deducted from CET1 capital if they exceed deduction thresholds

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

CECL

- In the event of an M&A transaction, an acquirer would continue using its transitional amounts based on its calculation as of the CECL adoption date, and would **not** add any transitional amounts of seller
- On December 21, 2018, the Federal Reserve announced that it would not alter its existing modeling framework for supervisory stress testing for the 2019, 2020 and 2021 cycles, and that although BHCs subject to company-run stress tests as part of CCAR must incorporate CECL beginning in the 2020 cycle, the Federal Reserve will not issue supervisory findings on those firms' allowance estimations in CCAR through 2021.
- **Potential Methods of Change:** Legislators and regulators continue to consider the potential effects of CECL:
 - 28 Republican House members wrote a letter urging FSOC to delay implementation of CECL and to conduct a comprehensive study of its effects on the banking industry and access to credit.
 - The FSOC included CECL on the agenda for the closed portion of its December 2018 meeting. Ahead of this meeting, financial industry trade groups, including the Bank Policy Institute (**BPI**) and the American Bankers Association, called for the FSOC to seek a delay in implementation of CECL until an impact study is performed.
 - On January 28, 2019, the Financial Accounting Standards Board, which issued CECL in 2016, held a public roundtable to discuss implementation issues related to CECL, including a proposal by regional bank representatives to bifurcate the credit loss estimates under CECL between balance sheet amounts and accumulated other comprehensive income.
 - In May 2019, a bipartisan group of 25 members of Congress wrote a letter to SEC urging it to delay the implementation of CECL, and Sen. Tills introduced a bill that would delay the implementation of CECL until a quantitative impact study can be completed.

Foreign Banking Organizations

- **General Outlook:** EGRRCPA and the FBO tailoring proposals would provide regulatory relief to FBOs under certain asset thresholds in line with similar relief proposed for U.S. firms.
 - EGRRCPA increased the statutory threshold for most of the Federal Reserve's EPS to \$250 billion in total consolidated assets.
 - In April 2019, the Federal Reserve released proposed rules to tailor EPS for FBOs and their U.S. IHCs, and the U.S. banking agencies proposed corresponding tailoring changes to their capital and liquidity rules.
 - These rules are similar to the proposals to tailor EPS and capital and liquidity rules for U.S. firms that are described in the Tailored Regulation slides.
 - As noted above in the Tailored Regulation section, the Federal Reserve expects to finalize the tailoring proposed rules in August 2019. It is not clear whether this timeline applies only to the proposals for U.S. firms or also to the proposals for FBOs and their U.S. IHCs.
 - Under the proposed rules, the requirements applicable to a firm would depend on which of the following categories the firm falls into:
 - **Category I** – N/A (only U.S. GSIBs)
 - **Category II** – Either:
 - ≥ \$700 billion in assets (combined U.S. assets for FBOs, and total consolidated assets for U.S. IHCs); or
 - ≥ \$75 billion in cross-jurisdictional activity (excluding liabilities to and collateralized claims on non-U.S. affiliates)
 - **Category III** – Either:
 - ≥ \$250 billion in assets; or
 - ≥ \$75 billion in one of nonbank assets, weighted short-term wholesale funding or off-balance sheet exposures
 - **Category IV** – Any other firm with ≥ \$100 billion in assets
 - Both FBOs and IHCs would be subject to their own categories. Some requirements applicable to a U.S. IHC would be based on the IHC's category – while some requirements based on the FBO parent's category would apply with respect to any U.S. IHC of the FBO, irrespective of the U.S. IHC's category.

Foreign Banking Organizations

The following chart summarizes the capital rules that would apply to U.S. IHCs under the FBO tailoring proposed rules.

Capital <i>based on the U.S. IHC's category</i>	U.S. IHC Category IV	U.S. IHC Category III	U.S. IHC Category II
AOCI recognized in capital			✓
CCyB (if deployed)		✓	✓
SLR		✓	✓
Company-run DFAST		Every two years	Annual
Supervisory DFAST	Every two years	Annual	Annual
CCAR	Streamlined annual	Annual	Annual
Proposed stress buffer requirements	✓	✓	✓
U.S. Basel III risk-based and leverage capital requirements	✓	✓	✓
U.S. TLAC	If FBO parent is GSIB	If FBO parent is GSIB	If FBO parent is GSIB

The following chart summarizes the liquidity and IHC-level SCCL rules that an FBO would have to satisfy with respect to any U.S. IHC under the proposal.

Liquidity & SCCL <i>based on the FBO's category</i>	U.S. IHC of FBO Category IV < \$50B weighted STWF	U.S. IHC of FBO Category IV ≥ \$50B weighted STWF	U.S. IHC of FBO Category III < \$75B weighted STWF	U.S. IHC of FBO Category III ≥ \$75B weighted STWF	U.S. IHC of FBO Category II
IHC-Level SCCL			✓	✓	✓
LCR		Reduced monthly	Reduced daily	Full daily	Full daily
Proposed NSFR		Reduced monthly	Reduced daily	Full daily	Full daily

Foreign Banking Organizations

The following chart summarizes the EPS requirements that would apply to Category II, III or IV FBOs.

	FBO Category IV < \$250B Global Assets	FBO Category IV ≥ \$250B Global Assets	FBO Category III	FBO Category II
Resolution Planning		Every three years, alternating full / targeted	Every three years, alternating full / targeted	Every three years, alternating full / targeted
Home country SCCL		✓	✓	✓
Requirement to create a U.S. IHC	If ≥ \$50B U.S. nonbranch assets	If ≥ \$50B U.S. nonbranch assets	If ≥ \$50B U.S. nonbranch assets	If ≥ \$50B U.S. nonbranch assets
Liquidity risk management	Slightly tailored	Slightly tailored	✓	✓
Internal liquidity stress testing	Quarterly	Quarterly	Monthly	Monthly
Internal liquidity buffer	✓	✓	✓	✓
FR 2052a reporting	Monthly if ≥ \$50B weighted STWF; None if < \$50B weighted STWF	Monthly if ≥ \$50B weighted STWF; None if < \$50B weighted STWF	Daily if ≥ \$75B weighted STWF; Monthly if < \$75B weighted STWF	Daily
Home country Basel III capital	✓	✓	✓	✓
Home country capital stress testing	Every two years	Every two years	Annual	Annual
U.S. chief risk officer	✓	✓	✓	✓
U.S. risk management	✓	✓	✓	✓
U.S. risk committee	✓	✓	✓	✓

Foreign Banking Organizations

The following chart summarizes the EPS requirements that would apply to FBOs that do not qualify as Category II, III or IV FBOs.

	FBO ≥ \$50B, < \$100B global assets	FBO ≥ \$100B, < \$250B global assets		FBO ≥ \$250B global assets	
		< \$50B combined U.S. assets	≥ \$50B, < \$100B combined U.S. assets	< \$50B combined U.S. assets	≥ \$50B, < \$100B combined U.S. assets
Resolution planning				Every three years, reduced	Every three years, reduced
Home-country SCCL				✓	✓
Internal liquidity stress testing				Annual global or CUSO	Annual global or CUSO
Home-country Basel III capital				✓	✓
U.S. chief risk officer			✓		✓
U.S. risk management			✓		✓
Requirement to create a U.S. IHC			If ≥ \$50B U.S. nonbranch assets		If ≥ \$50B U.S. nonbranch assets
Home-country capital stress testing		Every two years	Every two years	Annual	Annual
U.S. risk committee	May sit in home country	May sit in home country	✓	May sit in home country	✓

Foreign Banking Organizations

- **Other Regulatory Developments:**

- The Federal Reserve’s inaugural Supervision and Regulation Report, published in November 2018, highlighted concerns about FBOs.
 - The report noted that, contrary to a general downward trend in outstanding supervisory findings at large financial institutions, MRAs and MRIAs have increased for large FBOs.
 - The report stated that FBOs continue to face challenges regarding compliance with EPS, including the IHC requirement and risk management and reporting systems requirements.
- On April 1, 2019, the Federal Reserve published a final rule making changes to the procedures in the Federal Reserve’s Payment System Risk Policy governing the provision of intraday credit to U.S. branches and agencies of FBOs.
 - The rule eliminates reliance on an FBO’s strength of support assessment and status as an FHC in determining the level of intraday credit that U.S. branches and agencies of the FBO can receive.
 - The Federal Reserve indicated its belief that the rule will result in FBO net debit caps better tailored to FBOs’ use of intraday credit and will not constrain FBOs’ U.S. operations.

“Control” and “Controlling Influence”

- **General Outlook:** The existing definition of “control” under the Bank Holding Company Act (**BHC Act**) and Home Owners’ Loan Act (**HOLA**), and particularly the Federal Reserve’s interpretations of whether one company has a “controlling influence” over the management or policies of another company, have long created too much uncertainty in connection with investments in and by the banking sector.
- On April 23, the Federal Reserve released proposed amendments to its regulations on “controlling influence,” with comments due July 15, 2019. [See our client memorandum here for a detailed analysis of the proposal.](#)
 - Vice Chairman for Supervision Quarles reiterated his position that further clarity is necessary in this area, explaining that divining whether the Federal Reserve will find control under the existing framework requires “supplication to a small handful of people who have spent a long apprenticeship in the subtle hermeneutics of Federal Reserve lore, receiving the wisdom of their elders through oral tradition in the way that gnostic secrets are transmitted from shaman to novice in the culture of some tribes of the Orinoco.”
- The proposal would significantly expand the number of presumptions used in controlling influence determinations, a welcome step in the right direction. But it falls short of making the framework consistent with the ordinary meaning of “controlling influence” and the text and legislative history of the controlling influence test, which center around *exercise* of a controlling influence rather than mere *potential ability* to exercise a controlling influence.
- The following chart on slides 39 – 41 provides a simplified visual summary of the tiered presumptions of control (other than those specifically relating to investment funds) under the BHC Act set out in the Federal Reserve’s proposal.

“Control” and “Controlling Influence”

Presumptions of Control under the Federal Reserve Proposal

	Investor Controls Less than 5% (i.e., up to 4.99%) of each Class of Voting Securities	Investor Controls Between 5-9.99% of any Class of Voting Securities	Investor Controls Between 10-14.99% of any Class of Voting Securities	Investor Controls Between 15-24.99% of any Class of Voting Securities
Investor Benefits from Presumption of Non-Control	Yes	Yes, so long as no other factor would create a presumption of control	No	No
Number of Director Representatives of Investor	No presumption of control at less than 50% of board of directors	No presumption of control at less than 25% of board of directors	No presumption of control at less than 25% of board of directors	No presumption of control at less than 25% of board of directors
Director Representative of Investor as Board Chair	No presumption of control	No presumption of control	No presumption of control	Presumption of control
Director Representatives of Investor on Board Committees	No presumption of control	No presumption of control	No presumption of control at up to 25% or less of a committee that has the power to bind the company (including compensation, audit or executive committee)	No presumption of control at up to 25% or less of a committee that has the power to bind the company (including compensation, audit or executive committee)
Business Relationships Between Investor and Company – Quantitative Limits	No presumption of control	No presumption of control at less than 10% of annual revenues or expenses of investor and of company	No presumption of control at less than 5% of annual revenues or expenses of investor and of company	No presumption of control at less than 2% of annual revenues or expenses of investor and of company

“Control” and “Controlling Influence”

Presumptions of Control under the Federal Reserve Proposal

	Investor Controls Less than 5% (i.e., up to 4.99%) of each Class of Voting Securities	Investor Controls Between 5-9.99% of any Class of Voting Securities	Investor Controls Between 10-14.99% of any Class of Voting Securities	Investor Controls Between 15-24.99% of any Class of Voting Securities
Business Relationships Between Investor and Company – Qualitative Terms	No presumption of control	No presumption of control	No presumption of control if business relationships on market terms	No presumption of control if business relationships on market terms
Senior Management Official Interlocks	No presumption of control	No presumption of control unless more than 1 interlock or any CEO interlock	No presumption of control unless more than 1 interlock or any CEO interlock	Presumption of control
Management Agreement	Presumption of control	Presumption of control	Presumption of control	Presumption of control
Limiting Contractual Rights of Investor	No presumption of control	Presumption of control if investor has rights that significantly restrict discretion over major operational or policy decisions of company	Presumption of control if investor has rights that significantly restrict discretion over major operational or policy decisions of company	Presumption of control if investor has rights that significantly restrict discretion over major operational or policy decisions of company
Proxy Solicitations by Investor	No presumption of control	No presumption of control	Presumption of control if investor solicits proxies for director representatives comprising 25% or more of board of directors (when aggregated with investor's existing director representatives, if any) No presumption of control for proxy solicitation on other issues	Presumption of control if investor solicits proxies for director representatives comprising 25% or more of board of directors (when aggregated with investor's existing director representatives, if any) No presumption of control for proxy solicitation on other issues

“Control” and “Controlling Influence”

Presumptions of Control under the Federal Reserve Proposal

	Investor Controls Less than 5% (i.e., up to 4.99%) of each Class of Voting Securities	Investor Controls Between 5-9.99% of any Class of Voting Securities	Investor Controls Between 10-14.99% of any Class of Voting Securities	Investor Controls Between 15-24.99% of any Class of Voting Securities
Total Equity Controlled by Investor	No presumption of control at less than one third (up to 33.3%)	No presumption of control at less than one third (up to 33.3%)	No presumption of control at less than one third (up to 33.3%)	No presumption of control at less than 25%
Accounting Consolidation	Presumption of control if company is consolidated with investor under U.S. GAAP	Presumption of control if company is consolidated with investor under U.S. GAAP	Presumption of control if company is consolidated with investor under U.S. GAAP	Presumption of control if company is consolidated with investor under U.S. GAAP
Divestiture of Control	No presumption of control based solely on continued ownership of this reduced level of voting securities	No presumption of control based solely on continued ownership of this reduced level of voting securities	No presumption of control based solely on continued ownership of this reduced level of voting securities	Presumption of control for two years after reduction to less than 25% of each class of voting securities, unless 50% or more of each class of voting securities is owned by unaffiliated person or company, in which case there is no presumption of control upon reduction to less than 25%

Chapter 14: Financial Institutions Bankruptcy Reform

- **General Outlook:** With a Democratic House majority, calls to repeal the Orderly Liquidation Authority (**OLA**) have subsided, and the enactment of a new chapter 14 of the Bankruptcy Code (as an addition to OLA rather than a replacement) is more likely.
 - The Financial Institutions Bankruptcy Act, which is based on the Hoover Institution’s Chapter 14 proposal and would add a new Subchapter V (aka Chapter 14) to Chapter 11 of the Bankruptcy Code, passed the full House in 2016 and 2017.
 - Chapter 14 would facilitate SPOE resolution strategies for large financial companies by:
 - Facilitating the transfer of assets from a failed holding company to a bridge company to allow the continuing operation of operating subsidiaries outside of bankruptcy
 - Overriding cross-default rights in qualified financial contracts entered into by subsidiaries if certain conditions are satisfied, which is consistent with the ISDA Protocol
 - Providing a safe harbor from avoidance actions for transfers of assets to recapitalize the operating subsidiaries
 - In February 2018, the Treasury Department issued a long-awaited report in which it recommended the addition of a new chapter 14 to the Bankruptcy Code to facilitate the resolution of financial companies and thereby “narrow the path to OLA.”
 - FDIC Chairman McWilliams endorsed efforts to adopt Chapter 14 legislation in a November 2018 speech.

For more information on the Treasury’s OLA report, please visit the [FinReg](#) blog – “[Treasury: Retain but Reform OLA + Add New Chapter 14 to Bankruptcy Code](#)” (Feb. 22, 2018). For more information on the details of Chapter 14 of the Bankruptcy Code, please see the [testimony](#) of Davis Polk partner, Donald S. Bernstein, before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law, and the book “[Making Failure Feasible: How Bankruptcy Reform Can End ‘Too Big To Fail’](#)” by the Hoover Institution.

Living Wills

- **Change is Here**

- The Federal Reserve and FDIC issued a proposal in April to revise their rules under Dodd-Frank Section 165(d) (**165(d) Rule**)
- The FDIC also issued a separate ANPR on its IDI Plan requirements (**IDI Rule**).
 - No IDI Plan submissions will be required until a revised rule is issued.

- **Federal Reserve and FDIC 165(d) Rule Proposal**

- The proposal would exempt domestic firms with <\$100 billion of total consolidated assets and foreign firms with <\$250 billion of total global consolidated assets from the 165(d) Rule requirements.
- The proposal would tailor application in a manner consistent with EGRRCPA, as described below on slide 44.
- The proposal would be effective on the earlier of the first day of the first calendar quarter after the issuance of the final rule or November 24, 2019—before the year-end filing date for certain firms.

- **Key Changes in the 165(d) Rule Proposal**

- Tailoring content requirements and submission cadences and establishing content requirements for full, targeted and reduced resolution plans, as described below on slide 45.
- Updating certain procedural elements, including:
 - Allowing filers to apply for a waiver of certain informational content requirements
 - Establishing processes for identification of and de-designation of critical operations
 - Defining “material” for purposes of describing material changes since filing of the previously submitted resolution plan
 - Revising the requirement to provide the agencies notice of material events to make clear that it applies only to “extraordinary events,” defined as “a material merger, acquisition of assets or other similar transaction, or a fundamental change to a covered company’s resolution strategy”
 - Formalizing definitions for “deficiency” and “shortcoming”

For more information on this topic, please visit the [FinReg](#) blog – “[Federal Reserve Proposes Amendments to 165\(d\) Resolution Plan Rule](#)” (Apr. 8, 2019), “[Treasury Calls on the Federal Reserve to Reassess the BHC Act Control Framework to Facilitate Innovation](#)” (Aug. 6, 2018) and “[Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework](#)” (Jan. 24, 2018).

Living Wills

Overview of Tailoring Under the Federal Reserve 165(d) Rule Proposal

Biennial Filers	Triennial Full Filers		Triennial Reduced Filers
Category I	Category II	Category III	Other FBOs
2-year cycle (alternating full and targeted resolution plans) Next submission July 1, 2019 (full) July 1, 2021 (targeted)	3-year cycle (alternating full and targeted plans) Next submission July 1, 2021 (full) (the four FBOs that received shortcomings must submit project plans by July 1, 2020 as planned) July 1, 2024 (targeted)		3-year cycle (reduced plans) Next submission July 1, 2022 (reduced)
<ul style="list-style-type: none"> • Bank of America • Bank of New York Mellon • Citigroup • Goldman Sachs • JPMorgan Chase • Morgan Stanley • State Street • Wells Fargo 	<ul style="list-style-type: none"> • Barclays • Capital One • Credit Suisse • Deutsche Bank • HSBC • Mizuho • MUFG • Northern Trust • PNC Financial • Royal Bank of Canada • Toronto-Dominion • UBS • US Bancorp 		<ul style="list-style-type: none"> • 53 FBOs

The U.S. regional banks that are currently required under the existing 165(d) Rule to submit their next resolution plans by December 31, 2019 have filed a comment letter to the Federal Reserve and FDIC asking that the agencies promptly clarify that, consistent with the 165(d) Rule proposal, they do not expect the banks to file resolution plans in 2019. Absent this clarification, the banks would have to continue devoting substantial resources and personnel to prepare for a submission that would become unnecessary when the proposal is finalized.

Living Wills

Content Changes under the Federal Reserve 165(d) Rule Proposal

Full Resolution Plan	Targeted Resolution Plan	Reduced Resolution Plan
Public Section Unchanged from existing rule	Public Section Same requirements as full resolution plan	Public Section Must include only the following: <ul style="list-style-type: none"> Names of the material entities Description of core business lines The identities of the principal officers Description, at a high level, of the filer's resolution strategy, referencing the applicable resolution regimes for its material entities
Confidential Section Largely unchanged from existing rule, except the Executive Summary must now include: <ul style="list-style-type: none"> Description of each material change (defined below) experienced by the filer since the last submission Changes resulting from changes in laws or regulations, agency guidance or feedback, and material changes 	Confidential Section <ul style="list-style-type: none"> Defined core elements of a full resolution plan: capital, liquidity, plan for executing any recapitalization, updated quantitative financial information and analyses Changes resulting from changes in laws or regulations, agency guidance or feedback, and material changes Information responsive to a targeted information request 	Confidential Section <ul style="list-style-type: none"> Description of each material change experienced by the filer since the last submission Changes resulting from changes in laws or regulations, agency guidance or feedback, and material changes

Living Wills

• FDIC IDI Plan Rule ANPR

- The ANPR considers and invites comment on several topics, including: (1) two alternative frameworks for tiered resolution planning requirements, based on IDI size, complexity, funding structure and other factors, (2) revisions to the content and frequency of submissions, and (3) changes to the pattern of engagement between the FDIC and IDIs on resolution-related matters.
 - The ANPR also invites comment on whether the FDIC should raise the \$50 billion asset threshold, or if some other metric should be used, for determining which IDIs are subject to the IDI Rule.
 - Comments on the ANPR are due June 21, 2019. The FDIC has stated in the Spring Regulatory Agenda that it expects to release a notice of proposed rulemaking with respect to the IDI Rule in 2019.
- Tiered Resolution Planning Frameworks and Content Requirements
 - The ANPR proposes two alternative frameworks for tiered resolution planning requirements. Both frameworks would separate IDIs into three categories: A, B, and C. The largest and most complex IDIs would fall into Tier A, large and complex regional banks would fall into Tier B, and smaller and less complex IDIs would fall into Tier C.
 - Under the first proposed framework, Tier A IDIs would be subject to all of the informational requirements of the amended (and more streamlined) IDI Rule. Tier B IDIs would be subject to even more streamlined informational requirements than Tier A firms. Tier C IDIs would not need to submit a resolution plan.
 - Under the second proposed framework, the FDIC would tailor informational requirements for each tier A and Tier B firm, based on each firm's size, complexity, and other resolvability-related factors. Like the first framework, Tier C firms would not submit a resolution plan.

For more information on this topic, please visit the [FinReg](#) blog – “[FDIC Considers Amendments to Resolution Planning Requirements](#)” (Apr. 17, 2019).

Living Wills

– Frequency of Submissions

- Under the first proposed framework, the FDIC is considering having Tier A firms file biennially, while Tier B firms file triennially. The FDIC also suggests that submissions could alternate between full and targeted submissions, similar to the proposed 165(d) Rule.
- Under the second proposed framework, Tier A and Tier B firms would submit resolution plans biennially or triennially, depending on the characteristics of the firm.
- The ANPR also invites comment on the introduction of “Conditions-based supplemental resolution planning,” pursuant to which the FDIC, could subject IDIs, including Tier C firms, to immediate re-engagement and capabilities testing upon the IDI’s breach of a trigger demonstrating that the IDI’s financial condition has deteriorated.

– Engagement and Capabilities Testing

- The ANPR invites comment on a revised pattern of engagement between the FDIC and all IDIs subject to the IDI Rule, in which the FDIC develops each IDI’s resolution strategy, and then engages directly with IDI staff to collect information or receive feedback on that strategy.
- The ANPR also invites comment on how the FDIC could carry out and appropriately tailor regular capabilities testing for each IDI.

• Guidance

- Proposed resolution plan guidance for FBOs may be released in the future.
- Guidance on intra-group liquidity is expected in the future, although the timing on this proposed guidance is unclear.

For more information on this topic, please visit the [FinReg](#) blog – “[FDIC Considers Amendments to Resolution Planning Requirements](#)” (Apr. 17, 2019).

Living Wills

- **Feedback**

- The Federal Reserve and FDIC in March 2019 provided feedback on the U.S. regional banks' 2017 165(d) submissions, encouraging those firms to reduce the page count of their 2019 submissions.
 - Regional banks should only submit updated financial statements and “material” changes to the information in their 2017 submissions. Information that has not materially changed should be incorporated by reference.
 - Regional banks were exempted from additional informational requirements related to identifying their competent domestic and foreign regulators or other authorities, as well as a requirement to provide contact information for a senior official who could answer questions related to 165(d) submissions.
 - Firms are still allowed to submit information that would be helpful to the Federal Reserve and FDIC in their review of the 2019 submission, including improvements in the firm's resolvability since the 2017 plan submission.

For more information on living wills, please visit the [FinReg](#) blog – “[Feedback on Foreign Banks' July 2018 Resolution Plan Submissions – Key Takeaways](#)” (Dec. 28, 2018) and “[Resolution 2.0 – The Future of U.S. Resolution Planning for U.S. G-SIBs Starts to Come into Focus](#)” (Dec. 4, 2018).

Volcker Rule

- **General Outlook:** Changed by EGRRCPA; will be further changed by proposed amendments to regulations.
- **Proposed regulatory changes:**
 - The agencies released proposed amendments to the Volcker Rule regulations on June 5, 2018.
 - Vice Chairman for Supervision Quarles emphasized in his public statement about the proposal that it was the five agencies' "best first effort," but that they expected to make further changes in response to public comments, which he expressly invited to be robust and said they would be considered seriously.
 - On October 1, 2018, a group of seven Republican senators led by Sen. Crapo wrote a letter to the five agencies and the Secretary of the Treasury supporting the proposed amendments and encouraging the agencies to add additional exclusions to the definition of covered fund for venture capital, other long-term investment and loan creation vehicles.
 - The agencies have indicated that they will repropose changes to the Volcker Rule regulations before the end of 2019, particularly with respect to the covered funds rules. Vice Chairman for Supervision Quarles stated in May 2019 that he expects the "next step" in the Volcker Rule process in 60-90 days.
 - Statutory amendments in EGRRCPA will be addressed in separate rulemaking.
- **Key elements of the proposed changes include:**
 - Definition of Trading Account changed to remove the Purpose Test and replace it with a new, more objective Accounting Test
 - Under the Accounting Test, transactions are for the trading account if recorded at fair value on a recurring basis under the applicable accounting standards, which includes derivatives and available-for-sale securities.
 - Three-tiered compliance system with banking entities classified based on the size of their trading assets and liabilities
 - Banking entities with "moderate" or "limited" trading assets and liabilities would be subject to fewer compliance obligations.

Volcker Rule

- For underwriting and market-making activities, presumption of compliance with RENTD limitation if trading within internally set risk limits
- Limited proposed amendments to covered funds portion of the regulations, but the agencies invited comment on a wide range of issues, including the definition of “covered fund” and whether the exceptions to the definition of covered transaction under section 23A of the Federal Reserve Act and Reg W should be incorporated into the definition of covered transaction under Super 23A
- Elimination of Appendix B and modifications to Appendix A, including new qualitative informational requirements
- **See our visual memorandum [here](#) for further analysis of the proposed amendments.**
- **EGRRCPA:**
 - Enacts the community bank exemption:
 - Exempts from the Volcker Rule any IDI and any affiliate of an IDI that meets, and is not controlled by a company that does not *itself* meet, the following requirements:
 - ≤ \$10 billion in total consolidated assets; and
 - Total trading assets and trading liabilities of 5% or less of total assets
 - On December 18, 2019, the agencies released a proposed rule that would amend the Volcker Rule regulations to implement the community bank exemption pursuant to EGRRCPA, without any additional requirements.
 - The proposed rule would also modify the name-sharing restriction for covered funds pursuant to EGRRCPA by permitting a covered fund to share the same or similar name as a an investment adviser to the fund if (1) the investment adviser is not a bank, BHC or company that controls bank, (2) the investment advisor does not share the same or similar name with any such entity, and (3) the name does not contain the word “bank.”

For additional information on the Volcker Rule's future and EGRRCPA's impact on the Volcker Rule, please see our visual memoranda – [“Proposed Amendments to the Volcker Rule Regulations”](#) (June 18, 2018) and [“Bipartisan Banking Act Will Rebalance the Financial Regulatory Landscape”](#) (May 22, 2018).

Community Reinvestment Act

- **Change is Coming:** Leadership at the Treasury Department, OCC, FDIC and Federal Reserve have strongly signaled support for revising the Community Reinvestment Act (**CRA**) regulatory framework.
 - **OCC Out Front:** The OCC, without sign-on from the Federal Reserve or the FDIC, released an ANPR to begin the process of reforming the CRA regulatory framework to better achieve the statutory purpose of the CRA.
 - **Writing the Rule:** Top officials at the OCC, FDIC, and Federal Reserve stated at the May 16, 2019 hearing before the House Financial Services Committee that agency principals are meeting weekly to discuss CRA reform and are working toward a joint NPR.
 - On May 29, 2019, Chairman McWilliams stated the bank regulators are hoping to have a draft joint proposal in the next couple of weeks, with a formal NPR coming as soon as a couple of months after that.
 - **Not Yet Fully Aligned:** Comptroller Otting believes the agencies are “80 to 90 percent aligned” on how to accomplish this reform, but both he and other agency principals admitted to not yet knowing where opinions differ.
- **Democratic Points of View:**
 - While broadly agreeing with the need for change, Federal Reserve Governor Brainard prefers to moderately adjust the current regulatory framework, as opposed to following the transformational, metric-based approach outlined by the OCC.
 - In a letter to the Federal Reserve, OCC and FDIC, 16 Democratic senators led by Sen. Warner outlined:
 - Support for Treasury’s recommendation to update geographic assessment areas
 - Opposition to the OCC policies permitting banks with less than satisfactory CRA ratings to open/acquire new branches and requiring a direct relationship between a discriminatory/illegal credit practice and the bank’s CRA lending activities for there to be a ratings impact
 - Further, Sen. Warren has introduced a bill that would extend the applicability of CRA requirements beyond FDIC-insured banks to nonbank mortgage originators and increase the severity of penalties for CRA violations.
 - In a letter to Comptroller Otting, nine Democratic senators led by Sen. Brown expressed concern about changes to evaluation practices that they believe weaken CRA enforcement.
- **What’s Next?**
 - For more information on expected future CRA developments, see [What Comes Next with Respect to CRA Reform](#), Business Law Today, ABA Business Law Section (Dec. 11, 2018).

Community Reinvestment Act

Comptroller Otting's Framework for CRA Reform

1

Expand CRA-Qualifying Activities

- **Principle:** Current CRA approach is too focused on residential lending
- **Desired Change:** Expand the products and services that qualify under the CRA; more consideration is needed for small business lending, student lending, economic development opportunities and short-term, small-dollar consumer loans

Otting stated his support for (1) Increasing the revenue cap for small business loans under the community development test and (2) Allowing some activities involving religious groups to qualify under the CRA.

2

Broaden Assessment Areas

- **Principle:** The current approach of determining assessment areas based on the geographic footprint of branches and ATMs is at odds with technological advancement in banking
- **Desired Change:** Determine assessment areas based on where services are provided; consider where customers and employees are located

Otting suggested that a ratio could be used to help reflect a bank's commitment to the CRA.

3

Develop Metrics-Driven Evaluation Approach

- **Principle:** Evaluations are too subjective, are administratively burdensome and lack clarity and transparency
- **Desired Change:** Develop clearer metrics that can be applied consistently and serve as a more objective basis for examiner ratings; these metrics would facilitate transparency and would allow for more meaningful comparisons across banks

\$ Total CRA Activities

\$ Total Assets or
Total Tier 1 Capital

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

BSA/AML

- **General Outlook:** Regulatory change to the Bank Secrecy Act (**BSA**)/anti-money laundering (**AML**) regime remains a high priority. We still expect increased enforcement, and a focus on transparency, new financial technologies and platforms, and virtual currency. There is also increased focus on ultimate beneficial ownership of entities.
- **Possible Legislative Changes:**
 - The Coordinating Oversight, Upgrading and Innovating Technology, and Examiner Reform Act of 2019
 - Focused on improving AML/countering the financing of terrorism oversight and modernizing the AML system
 - Advanced to the full House with a favorable recommendation by unanimous vote on May 9, 2019
 - The Corporate Transparency Act of 2019
 - Would amend the BSA to require that the beneficial owners of corporations or limited liability companies be disclosed to FinCEN at the time of formation and that such information be updated annually
 - Currently with the House Financial Services Committee
 - The Senate Banking Committee also held a hearing on the topic of beneficial ownership information on May 21, 2019 – “Combating Illicit Financing By Anonymous Shell Companies Through the Collection of Beneficial Ownership Information” – and although witnesses did not discuss the House bill, they emphasized the need for a central beneficial ownership repository.
 - The Financial Reporting Threshold Modernization Act
 - Would increase the dollar thresholds for suspicious activity reports and currency transaction reports
 - Currently with the House Financial Services Committee
 - The Kleptocracy Asset Recovery Rewards Act
 - Would establish within the Department of the Treasury the Kleptocracy Asset Recovery Rewards Program and authorize rewards to whistleblowers that provide information to the government about assets of corrupt foreign governments held at U.S. financial institutions
 - Currently in the Senate

PRUDENTIAL DIRECTIVES AND THE REGULATORY LANDSCAPE

BSA/AML

- **Regulatory Developments and Guidance: Resource Sharing, Technological Innovation and Virtual Currency**

- In late 2018, the OCC, Federal Reserve, FDIC, NCUA, and FinCEN issued interagency statements that:
 - Addressed ways in which small banks and credit unions can collaborate in order to share resources to manage their BSA/AML obligations ([October 3, 2018](#))
 - Encouraged technological innovation in developing new, and/or augmenting current, BSA/AML compliance programs ([December 3, 2018](#)).
- FinCEN released [interpretive guidance](#) on May 9, 2019 about how FinCEN regulations relating to money services businesses apply to certain business models involving money transmission denominated in convertible virtual currencies (**CVCs**).
 - The interpretive guidance is not meant to establish new regulatory expectations or requirements, but rather provides FinCEN's interpretations of how its regulations apply to eight types of convertible virtual currency businesses.
- In addition, FinCEN issued an [advisory](#) on May 10, 2019 warning of threats posed by virtual currency misuse. The advisory is intended to assist financial institutions in identifying and reporting suspicious activity related to criminal exploitation of CVCs for money laundering, sanctions evasion, and other illicit financing purposes.

- **Enforcement**

- In recent years, FinCEN, banking supervisory agencies, including the NYDFS, as well as securities regulators, have brought substantial enforcement actions for BSA/AML violations.
 - The political and regulatory climate suggests that these efforts will continue.

For more information, please visit the [FinReg](#) blog – [“Bank Secrecy Act Reform Legislation Advanced Unanimously by House Financial Services Committee”](#) (May 17, 2019), [“U.S. Regulators Announce BSA/AML Enforcement Actions Against U.S. Broker-Dealers”](#) (Jan. 2, 2019), [“FinCen and Banking Regulators Issue Joint Statement on Innovation in BSA/AML Compliance”](#) (Dec. 10, 2018) and [“One Small Step for AML: Federal Banking Regulators Issue Joint Statement on BSA/AML Resource Sharing”](#) (Oct. 8, 2018).

OFAC Sanctions

- **General Outlook:** The Trump administration has continued to make aggressive use of existing economic sanctions authorities to advance national security and foreign policy goals. The most significant sanctions policy changes from the prior administration include:
 - **Iran:** The United States has [withdrawn](#) from the Joint Comprehensive Plan of Action (the Iran nuclear deal) and as of November 2018 [fully reinstated](#) secondary sanctions that may be imposed against non-U.S. persons engaging in certain trade with Iran.
 - **Venezuela:** Beginning in August 2017, the United States has imposed significant sanctions targeting the Maduro regime in Venezuela, including restrictions on certain financial transactions involving the [Government of Venezuela](#) and the imposition of blocking sanctions against [PdVSA](#) and Venezuela's Central Bank.
 - **Cuba:** The administration has partially reversed President Obama's easing of sanctions on Cuba, re-imposing some travel restrictions and introducing a new prohibition on direct financial transactions with certain Cuban entities. Additional changes are likely in the near future. The U.S. has also for the first time [permitted lawsuits](#) to proceed under Title III of the 1996 Helms-Burton Act against companies doing business in Cuba that involves "trafficking" in confiscated properties subject to claims by U.S. nationals.
- **Legislative Developments:** The [Countering America's Adversaries through Sanctions Act \(CAATSA\)](#), which provides authority for additional sanctions against Iran, Russia, and North Korea, was signed into law on August 2, 2017. Among other things, CAATSA codifies U.S. sanctions relating to Russia, and gives Congress the authority to review and disapprove significant changes in Russia sanctions policy.
- **Compliance and Enforcement:** The approach of the Treasury Department's Office of Foreign Assets Control (**OFAC**) to civil sanctions enforcement has not materially changed. OFAC has, however, placed a greater emphasis on specific compliance program commitments in settlement agreements resolving sanctions enforcement cases. Consistent with this emphasis, OFAC on May 3, 2019 published [A Framework for OFAC Compliance Commitments](#), a guidance document that sets forth OFAC's views of the essential elements of an effective economic sanctions compliance program.

For more information on developments regarding economic sanctions, please visit the [FinReg](#) blog's Economic Sanctions section [here](#).

Derivatives

- **General Outlook:** The CFTC continues to make incremental changes to its swap regime, though further changes are uncertain in light of the exit of Chairman Giancarlo. The SEC appears poised to begin the process of registration for security-based swaps dealers.
- **Tarbert Set to Become CFTC Chairman**
 - President Trump has nominated Heath Tarbert, a senior Treasury Department official, to replace Chairman Giancarlo. A confirmation vote is expected the week of June 3, 2019.
 - Market participants expect Chairman Giancarlo to try to finalize cross-border and swap execution facility rules sometime in June.
- **SEC Rulemaking and Registration:** The SEC is advancing towards the registration of security-based swap dealers (**SBSDs**) and major security-based swap participants (**MSBSPs**).
 - While it is not yet certain, market participants believe that the registration date for SBSDs and MSBSPs will be 18 months after the date on which capital, margin and segregation requirements for SBSDs and MSBSPs is published in the *Federal Register*.
- **Recent Developments**
 - The SEC proposed a package of cross-border rules for security-based swaps in May 2019.
 - The CFTC's Division of Enforcement published its enforcement manual publicly for the first time in the agency's history in May 2019.

For more information, please see the [FinReg](#) blog – “[SEC Cross-Border Proposal Balances Burdens and Benefits of New SBS Regime](#)” (May 16, 2019).

Brokered Deposits

- **General Outlook:** The FDIC has published an ANPR to undertake a “comprehensive review” of brokered deposits and interest rate caps for banks that are less than well capitalized.
- The ANPR is not a specific proposal, but sought comments, which were due by May 7, 2019, on issues including:
 - Specific or other technology changes that the FDIC should take into account in its review
 - Current treatment of certain deposits as brokered or not brokered
 - Ways for the FDIC to provide sufficient clarity regarding who is or is not a deposit broker and what is or is not a brokered deposit
 - Any necessary statutory changes
- Modernization of the approach to brokered deposits could potentially result in certain deposits, including certain sweep deposits and deposits in which an affiliate plays a role, no longer being treated as brokered deposits.
- At the May 16 hearing before the House Financial Services Committee, Chairman McWilliams confirmed that modernizing the brokered deposits definition is a top priority for her agency.

Regulation Best Interest

- The SEC has proposed rules and interpretations (**Regulation Best Interest** or **Reg BI**), which are open for public comment and seek to enhance the standard of conduct of broker-dealers and investment advisers when they interact with retail investors.
- **General Outlook:** A final vote has been scheduled for June 5, 2019, and the new rule is expected to be approved, but the threat of litigation looms and some states are forging ahead with their own (often more stringent) standards.
 - In New York, a proposed bill would require non-fiduciary advisors to provide a "plain-language" disclosure stating that they are not required to act in their clients' best interests.
- Congressional Democrats have expressed opposition to the proposal and called for a higher, fiduciary standard that they believe to be consistent with the requirements of Dodd-Frank.
 - In a letter written by Rep. Waters and Sens. Brown and Murray, thirty-five Congressional Democrats urged the SEC to revise Reg BI "consistent with [Dodd-Frank] and require brokers to abide by the same high standard that currently applies to investment advisers so that their advice to retail investors is provided without regard to their financial and other interests."
 - A Democratic legislative proposal would require the SEC to conduct a usability test on the new disclosures forms before finalizing Reg BI.
 - The SEC's Director of the Division of Investment Management has stated that there is no gap between what Dodd-Frank proposed and Reg BI because the core principles of both are the same.
 - However, the SEC Investor Advisory Committee has stated the proposal can be strengthened by explicitly characterizing the best interest standard as a fiduciary duty—although it should be made clear that what specific obligations flow from said fiduciary duty will differ according to different business models.

For more information on Regulation Best Interest, please see the Davis Polk Client Memorandum – [“SEC Proposes Enhanced Standards for Advice to Retail Investors”](#) (May 7, 2018).

Regulation Best Interest

- **Reg BI: Broker-Dealers**

- Under the proposed regulation, a broker-dealer or associated person would be required to act in the “best interest” of the retail customer at the time the recommendation is made, without placing the financial or other interests of the broker-dealer or associated person ahead of the interest of the retail customer.
- To meet the best interest standard, broker dealers must also:
 - Establish, maintain, and enforce written policies and procedures reasonably designed to:
 - Identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations
 - Identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations

- **Reg BI: Investment Advisers**

- For investment advisers, the proposed regulation seeks to reaffirm, and in some cases clarify, certain aspects of the fiduciary duty that an investment adviser owes to its clients under Section 206 of the Advisers Act in a single release.
- This release would seek to restate clearly the fundamental elements of an investment adviser’s duty of loyalty and duty of care, including duties to provide advice that is:
 - In the client’s best interest
 - To seek best execution
 - To act and to provide advice and monitoring over the course of the advisory relationship
 - To put its clients’ interests ahead of its own
- While most, if not all, of the above is familiar, it is notable that the SEC has sought to compile in a single interpretation a wide body of law that is dispersed across numerous rules, court decisions, SEC releases and other guidance.

Board Interlocks

- **General Outlook:** The Depository Institutions Management Interlocks Act (**DIMIA**), implemented by Regulation L, contains a “major assets” prohibition that prevents a management official of a depository organization with > \$2.5 billion in total assets (or any affiliate thereof) from serving as a management official of an unaffiliated depository organization with > \$1.5 billion in total assets (or any affiliate thereof). Further action on the proposal outlined below is expected in July 2019, according to the Spring Regulatory Agenda.
- The Federal Reserve, FDIC and OCC published a proposal in December 2018 to **raise the “major assets” thresholds** to only apply to depository organizations with **≥ \$10 billion in total assets**.
 - The thresholds have not been revised since first enacted in 1996.
 - A depository organization would still have the ability to seek an exemption from the revised threshold.
 - No changes would be made to the geographically-based community or metropolitan statistical area prohibitions, which continue to apply to all depository organizations regardless of size.
- The banking agencies also asked for comment on ways to **update** the revised thresholds on a **go-forward basis**:

Approach	Description
1	Adjust the thresholds to maintain the same total number of banking institutions subject to the prohibition as when DIMIA was first enacted
2	Multiply the thresholds by match the proportion of growth in total assets since 1996 (estimated to be 3.5x)
3	Adjust the thresholds for inflation

For more information on the interlocks proposal, please visit the [FinReg](#) blog – “[Board Interlocks and Investment in the Banking Sector](#)” (Feb. 5, 2019).

Board Interlocks

- In the digital era, the prohibition on interlocks, especially at the director level, can stand in the way of investment into the banking sector
 - DIMIA applies to both management and director interlocks, but as a practical matter is typically of concern for directors
 - The exemption process typically involves obtaining approval from more than one regulator and significant delay
- Raising the thresholds is one method to encourage more investment in fintech business models that choose a banking charter and, when combined with the Federal Reserve's modernization of the control rules, may encourage more innovation

Industry Views

- The ABA supports a “modern” look at the thresholds, but cautioned against an arbitrary threshold such as \$10B
 - Instead, the ABA suggested an upward revision based on a bank's share of total industry assets
 - If set at a “conservative” 1% in total industry assets, the thresholds would rise to \$17.9B
- BPI supports raising the thresholds to \$10B and recommended indexing future adjustments to asset growth
 - BPI believes \$10B is an asset size at which a management interlock may cause anti-competitive harm
- Both the ABA and BPI advocated for exempting officials at foreign affiliates
 - Foreign affiliates conduct business in host jurisdictions and as such there is no nexus to the U.S. banking market and therefore no competition concern
- BPI further advocated for exempting certain U.S. non-depository affiliates—those that neither provide deposit or credit services nor engage in activities closely related to banking under section 4(c)(8) of the BHC Act.
 - Companies that do not engage in such activities, as a result of the lack of similarity and substitutability of products and services offered, cannot be reasonably viewed as a competitor of an unaffiliated depository institutions

Executive Compensation

- **General Outlook:** On March 5, 2019, The Wall Street Journal reported that U.S. federal banking regulators plan to revive efforts to regulate financial institution incentive compensation, as required under Section 956 of Dodd-Frank.
 - The relevant interagency rule, which was last re-proposed by six agencies in the spring of 2016, was never finalized and which seems unlikely to be approved, in light of the Core Principles.
 - The Wall Street Journal indicated that the current effort is in its “early stages” and is being led by “top officials” of at least the Federal Reserve, the FDIC and the OCC.
 - On April 29, 2019, Comptroller Otting said his agency planned to move ahead with promulgation of the rule and that his goal is to propose a new version of the rule by the end of 2019.
- In August 2018, Sen. Warren introduced the Accountable Capitalism Act, which would prohibit directors and officers of U.S. corporations from cashing out on equity compensation for five years after receiving such compensation, and for three years after a stock buyback, in order to disincentivize corporate use of equity compensation and stock buybacks to increase executive compensation. Prohibited cash-outs would incur a civil penalty. On February 13, 2019, Sen. Rubio echoed criticism of stock buyback programs, stating that he will file a bill taxing corporate buybacks the same way as dividends to eliminate the tax advantage of buybacks over dividends.
- On December 2018, the SEC adopted the hedging disclosure rule implementing Section 955 of Dodd-Frank. The rule requires public companies to describe any practices or policies regarding the ability of certain employees, officers or directors to purchase securities or other financial instruments or engage in transactions to hedge or offset a decrease in the market value of equity securities granted to or held by the employee, officer or director. For more information, please see our December 21, 2018 client memorandum [here](#).
- In remarks in November 2018 and, again, in an address at a corporate governance conference on March 8, 2019, SEC Commissioner Jackson urged the SEC to finalize Dodd-Frank rules on clawbacks and pay versus performance.

For more information on developments in executive compensation, please visit the [FinReg](#) blog – [“Bank Pay Rules May Be Resurrected”](#) (March 12, 2019).

Cannabis-Related Banking

- **General Outlook**

- The direction of the federal regulatory and enforcement framework for financial institutions providing services to U.S. cannabis-related businesses has been unclear, and therefore virtually all banking organizations consider providing direct banking services to such businesses too perilous.
- Two bills offering federal relief for related banking services have been garnering bipartisan backing. Despite support for legislative reform from Treasury Department officials, banking regulators, states attorney general and the American Bankers Association, it remains uncertain whether either cannabis banking bill will be enacted this year.

- **Cannabis Banking Bills**

- The **Secure and Fair Enforcement Banking Act of 2019 (SAFE Banking Act)** was introduced in the House in March 2019. It has 184 cosponsors, including 20 Republicans.
- The **Strengthening the Tenth Amendment Through Entrusting States Act (STATES Act)** was most recently introduced in the House and the Senate in April 2019. The House bill has 47 co-sponsors, including 16 Republicans. The Senate bill has nine co-sponsors, including five Republicans.
- Neither bill would legalize cannabis at the federal level or remove cannabis from Schedule 1 under the Controlled Substances Act (**CSA**). However, the STATES Act would amend the CSA to render inapplicable CSA prohibitions on cannabis-related conduct that complies with state or tribal law.
- The bills would permit depository institutions, in the case of the SAFE Banking Act, or financial institutions, in the case of the STATES Act, to provide financial services to cannabis-related businesses that comply with state laws regulating legal cannabis-related activity.
- **Our visual memorandum analyzing these issues, updated in April, includes an in-depth discussion of both bills. It can be accessed [here](#).**

For a link to our article regarding cannabis-related banking in Thomson Reuters' *Practical Law*, please visit the [FinReg](#) blog – "[Practical Law: Financial Services and the US Cannabis Sector](#)" (Apr. 5, 2019), and for more information regarding cannabis-related banking developments, please visit the [FinReg](#) blog – "[Bipartisan Support for Cannabis Banking Safe Harbor Reaches New High with Letter from Attorneys General](#)" (May 9, 2019).

Cannabis-Related Banking

- **Cannabis Banking Bills – Possible Expansion:** According to press reports, to bolster Republican support for the bills, several possible amendments are being considered, including:
 - Extending the financial services protections to products derived from hemp; and
 - Prohibiting regulators from ordering banks to terminate certain customers or groups of customers without a valid reason or solely for reputational risk reasons, in an effort to prevent a recurrence of the DOJ’s Obama-era Operation Choke Point.
- **Hemp:**
 - The 2018 Farm Bill removed hemp from the definition of marijuana in Schedule I of the CSA.
 - To assume primary regulatory authority over hemp production, states must submit a plan to the the U.S. Department of Agriculture (**USDA**) and the USDA must approve the plan.
 - In the absence of an approved state plan, regulation of hemp production within a state would be subject to the federal plan established and implemented by the USDA.
 - The General Counsel of the USDA issued a [memorandum and legal opinion](#) on May 28, 2019 concluding that:
 - As of enactment of the 2018 Farm Bill on December 20, 2018, hemp and tetrahydrocannabinols (**THC**) in hemp have been removed from Schedule I of the CSA and are no longer controlled substances, and the decontrolling of hemp and TCH in hemp is self-executing. The CSA implementing regulations must be updated to reflect the amendments to the CSA but the publication of updated regulations is not necessary to execute the removal of hemp and TCH from Schedule I.
 - After the USDA publishes regulations implementing the 2018 Farm Bill hemp production provisions, states and Indian tribes may not prohibit the interstate transportation of hemp lawfully produced under a state or tribal plan or under a license issued under a USDA plan; nor may states and Indian tribes prohibit the interstate transportation of hemp lawfully produced under the 2014 Farm Bill.
 - The opinion explicitly disagreed with an Idaho court and agreed with a West Virginia court’s interpretation of the 2014 and 2018 Farm Bills.
 - The 2018 Farm Bill does not affect the authority of the Secretary of Health and Human Services or the Commissioner of the Food and Drug Administration (**FDA**) under applicable FDA laws.

Fintech Charters

- **General Outlook:** Different views on approach and an intense stakeholder scrum developing.
- **Potential Methods of Change:**
 - **Charter**
 - On July 31, 2018, the OCC announced that it would begin accepting applications for special purpose national bank charters from **nondepository** fintech companies engaged in the business of banking.
 - The release of the OCC's final policy statement and accompanying licensing manual supplement was quickly followed by criticism as well as litigation from the NYDFS and the Conference of State Bank Supervisors (CSBS).
 - The NYDFS has won a round against the OCC in its suit to declare that the OCC exceeded its authority under the National Bank Act (**NBA**) and violated the U.S. Constitution's 10th Amendment by usurping powers belonging to states. On May 2, 2019, the NYDFS defeated the OCC's motion to dismiss, permitting the NYDFS to proceed with claims related to the NBA. The court found that the phrase "business of banking" in the NBA requires that a chartered bank take deposits.
 - Comptroller Otting has stated that, despite ongoing conversations with several companies exploring the charter, he expects this ruling will deter potential applicants.
 - The CSBS also filed a suit against the OCC, reasserting its previous legal objections. That suit is pending.
 - The court win by the NYDFS, even though interim, creates a disincentive for investors to file for the OCC's fintech charter.

For more information, please visit the [FinReg](#) blog – "[The Fintech Charter Goes into Hibernation](#)" (May 3, 2019), "[Treasury Calls for Banking Regulators to Harmonize and Modernize Permissible Activities of Banking Organizations](#)" (Aug. 13, 2018), "[Treasury Tailored R&R – New and Important for Fintech Charters](#)" (Aug. 6, 2018) and "[Treasury Fintech Report Addresses Wide-Ranging Topics with Reform Recommendations](#)" (July 31, 2018).

Fed Faster Payments

- **General Outlook:** The Federal Reserve Faster Payments initiative is caught in the middle of a stakeholder battle between The Clearing House on one side and smaller banks and fintechs on the other.
- **Federal Reserve Faster Payments Proposal:**
 - In October 2018, the Federal Reserve released a request for comment on actions the Federal Reserve could take to support faster payments in the United States. It proposed two actions:
 - A Federal Reserve-developed service for real-time interbank settlement of faster payments 24x7x365
 - A liquidity management tool that would enable transfers between Federal Reserve accounts on a 24x7x365 basis to support real-time interbank settlement of faster payments by the private sector or the Federal Reserve Banks
 - Comments on the proposal revealed three camps:
 - Larger financial institutions are in favor of the Federal Reserve developing a liquidity management tool but against the Federal Reserve developing its own real-time interbank 24x7x365 settlement system.
 - Concerns are around interoperability of the Federal Reserve's system with the current real-time system operated by The Clearing House, unnecessary competition between the Federal Reserve and the private sector, and duplicative costs.
 - Community banks and credit unions want a clear decision made by the Federal Reserve on its involvement and are in favor of the Federal Reserve developing a real-time interbank settlement system.
 - Smaller institutions see a strong role for the Federal Reserve in this space as reducing the need for small institutions to give larger ones their money and customer data.
 - Fintechs and general corporates, such as Amazon, Walmart, and Google, are in favor of the Federal Reserve developing a real-time interbank settlement system and are in favor of this service being extended to non-bank providers.
 - The Federal Reserve has not indicated whether it will move forward with either proposed action.
 - In his May 2019 testimony before the House Financial Services Committee, Vice Chairman for Supervision Quarles stated, "There are strong reasons to want the private sector to be the area where there is innovation . . . If the [Federal Reserve] were to have an offering in the faster payments area, there are statutory standards we have to meet to ensure that it would be on a level playing surface with the private sector. But no decision has been made. . . . We don't have a concrete timeline."

Appendix: Executive Order and Treasury Reports



Executive Order and Treasury Reports

Executive Order and Treasury Reports

President Trump issued an Executive Order on Core Principles for Regulating the United States Financial System (**Core Principles**).

[February 2017](#)

The Treasury Department has published six reports on the conformity of U.S. financial regulations to the Core Principles, all of which are designed to influence financial regulatory reform:

- *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (**Treasury Banking Report**)

[June 2017](#)

- *A Financial System that Creates Economic Opportunities: Capital Markets*

[October 2017](#)

- *A Financial System that Creates Economic Opportunities: Asset Management and Insurance*

[October 2017](#)

- *Financial Stability Oversight Council Designations* (**Treasury FSOC Report**)

[November 2017](#)

- *Orderly Liquidation Authority and Bankruptcy Reform* (**Treasury OLA Report**)

[February 2018](#)

- *A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* (**Treasury Fintech Report**)

[July 2018](#)



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