

The Systemic Risk Designation Improvement Act of 2016: A Different Approach to Regulatory Relief for Regional and Specialty Banking Organizations

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Today, the House of Representatives passed, by a 254-161 vote, the [Systemic Risk Designation Improvement Act of 2016](#) (the “Act”), which is designed to relieve regional and specialty banking organizations from enhanced prudential standards and heightened supervision requirements under the Dodd-Frank Act. The Act would, after a one-year phase-in period, repeal the \$50-billion-in-assets threshold and instead would impose such requirements only on (1) BHCs that have been designated as G-SIBs by the Financial Stability Board (the “FSB”) on the date the Act is enacted and (2) other BHCs affirmatively designated as systemically important by the FSOC using the [indicator-based measurement approach](#) established by the Basel Committee on Banking Supervision, which would require the FSOC to consider each BHC’s size, interconnectedness, complexity and global cross-jurisdictional activities, as well as the extent of readily available substitutes for services the BHC provides. The Basel Committee’s indicator-based measurement approach is more quantitative than the approach the FSOC currently uses to designate nonbank financial companies as systemically important, which uses statutory factors, as well as an analytical framework and an assessment of transmission channels described in guidance, and permits greater consideration of qualitative factors and exercise of discretion.^[1]

The Act would exempt regional and specialty banking organizations from many of the requirements to which they are, or upon adoption of final rules will be, subject under Title I of the Dodd-Frank Act. As a result, regional and specialty banking organizations would no longer be automatically subject to requirements to prepare living wills and submit to supervisory stress testing, most of the Federal Reserve’s enhanced prudential standards rules,^[2] the single-party counterparty credit limit and the requirement that the Federal Reserve prescribe early remediation requirements. The Act would also restrict the Federal Reserve’s authority under Section 165 of the Dodd-Frank Act to prescribe more stringent capital, leverage and liquidity requirements and limits, such as the current G-SIB surcharge, to designated systemically important BHCs and nonbank SIFIs. The Act would not affect broadly applicable capital, leverage and liquidity requirements and limits that have been imposed under other statutory authority.

The vote on the Act was not strictly along party lines, with [20 Democrats](#) joining the Republicans voting in favor of the Act. The Act was [co-sponsored](#) by five Republicans and four Democrats, and an [earlier version of the bill](#) passed the House Financial Services Committee last year with [the support of one-third of the Democratic Committee members](#). This rare show of bipartisanship, notwithstanding the [threat of a Presidential veto](#) and the low likelihood that the Act will be passed in the lame-duck Senate, reflects the strong sense of many that the enhanced regulation of regional and specialty banking organizations has gone too far and needs recalibration. We suspect that some senior financial regulators may share that sense; [Federal Reserve Governor Daniel Tarullo](#) has suggested that the \$50 billion asset threshold should be raised to \$100 billion and that BHCs with between \$100 billion and \$250 billion in assets should be subject to a limited subset of enhanced prudential standards. Indeed, the Act’s policy goal of lightening the regulatory burden on regional and specialty banking organizations is shared with various predecessor bills, some of which aimed to simply raise the asset threshold for enhanced prudential regulation to a much higher number, for example \$250 billion or \$500 billion.

In some respects, the Act is in tension with House Financial Services Committee Chair Jeb Hensarling's [Financial CHOICE Act](#). The Act would preserve the FSOC's authority to designate nonbank financial companies as systemically important and expand its authority by authorizing it to designate regional and specialty banking organizations as systemically important, though it is expected that, under the incoming Administration, the FSOC would be unlikely to do so. In light of both the MetLife suit and potential changes to cost-benefit analysis, as set forth in the Financial CHOICE Act, any attempt to designate regional and specialty banking organizations faces an uphill battle. By contrast, the Financial CHOICE Act would strip the FSOC of its authority to designate nonbank financial companies as systemically important and would extend regulatory relief to banking organizations based on their leverage ratios and supervisory ratings, not their asset size.

The Act would also hardwire into federal law both the current G-SIB designations made by the FSB and the Basel Committee's indicator-based approach to measuring systemic importance.^[3] We believe that the Act represents the first time that Basel Committee and FSB standards, which can be changed by those organizations, would be hardwired into a U.S. statute and that recognition of this fact was what prompted Rep. Warren Davidson to add a provision clarifying that the Act may not be construed as "broadly applying international standards," except as specifically provided in the Act. The Financial CHOICE Act leans the other direction by limiting the ability of U.S. federal financial regulators to make agreements in bodies that set international financial standards.

Although the Act would not exempt G-SIBs from enhanced prudential standards or heightened supervisory requirements, it would open the door to the possibility of future regulatory relief, however unlikely such relief may be in the near future. Consistent with the process currently applicable to nonbank SIFIs, the Act would require the FSOC to reevaluate at least annually all designations of BHCs as systemically important. The FSOC could rescind the designation of a BHC as systemically important, although doing so would require the votes of two-thirds of the voting members of the FSOC, including the Secretary of the Treasury.

As a result of the passage of the Act, we expect some form of regulatory relief for regional and specialty banking organizations to be part of Rep. Hensarling's Financial CHOICE Act 2.0, though it remains to be seen what means that bill will adopt to achieve this goal.

Law clerk Conrad Scott contributed to this post.

[1] The Act would not change the approach used by the FSOC to designate nonbank financial companies as systemically important.

[2] BHCs with \$50 billion or more of total assets would be subject to the risk committee requirements that apply to all BHCs that are publicly traded and have \$10 billion or more of total assets. It is possible that the Federal Reserve would revise its rules on company-run stress tests that currently apply to BHCs with total assets between \$10 billion and \$50 billion to cover BHCs with \$50 billion or more of total assets that have not been designated as systemically important.

[3] Although all BHCs that are G-SIBs at the time the Act is enacted would be deemed to have been designated as systemically important, the Act would not use the FSB's G-SIB designations to determine on an ongoing basis which BHCs are systemically important. The Basel Committee's indicator-based measurement approach is the methodology used by the [FSB to identify G-SIBs](#), however, so the result could be similar depending on how the FSOC would choose to apply the methodology, including what threshold it would select for designation.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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