Financial Services Regulatory Reform in 2018

A reference tool to be updated from time to time

Version as of May 11, 2018

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. 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.

Davis Polk

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Financial regulatory reform will occur through a complex mix of changes in personnel, regulations, statutes, interpretations and guidance, with the courts also brought in by stakeholders on all sides

Complex Mix of Legislative and Regulatory Changes

How Changes Will be Made

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 five 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* (**Treasury Capital Markets Report**)	October 2017
• *A Financial System that Creates Economic Opportunities: Asset Management and Insurance* (**Treasury Asset Management Report**)	October 2017
• *Financial Stability Oversight Council Designations* (**Treasury FSOC Report**)	November 2017
• *Orderly Liquidation Authority and Bankruptcy Reform* (**Treasury OLA Report**)	February 2018
The Treasury Department will publish one additional report containing recommendations on non-bank financial institutions, financial technology and financial innovation	

Complex Mix of Legislative and Regulatory Changes

Legislative Developments

- Several legislative proposals form the backdrop for the overall regulatory reform policy discussion and are referred to throughout these slides
  - The Economic Growth, Regulatory Relief and Consumer Protection Act (**Bipartisan Banking Bill**) was passed by the full Senate on March 14, 2018
    - The Bipartisan Banking Bill had significant support from both sides of the aisle, with 16 Democrats and 1 Independent joining all 50 voting Republicans in passing the final bill
    - Discussion of the Bipartisan Banking Bill has now moved to the House. If the House passes a version of the bill that differs from the Senate version, these differences will need to be reconciled in conference and sent back to both chambers. Whether any revised version of the bill would maintain its strong bipartisan support – essential to surviving a filibuster – in the Senate is unclear, with one of the bill's Democratic supporters, Senator Warner, threatening to "encourage all 17 [Senate] Democrats who previously voted for the bill to vote against it" if the House makes changes
    - On April 5, President Trump reiterated his support for the bill, saying "it should be done fairly quickly"
  - The Financial CHOICE Act of 2017 (**CHOICE Act**) was passed by the full House on June 8, 2017
    - Reflects House Republican positions on a wide range of topics but is no longer being proposed in the form of one comprehensive bill
    - Components of the CHOICE Act have been passed by the House as separate bills and may be proposed on an à la carte basis as further standalone bills or as amendments to Senate bills as they are considered by the House. Rep. Hensarling has tempered his early insistence on bicameral negotiations of additional measures as a condition of the House's consideration of the Bipartisan Banking Bill, conceding that he is satisfied by movement toward provisions of the CHOICE Act and other initiatives becoming law through separate bills rather than as a part of the Bipartisan Banking Bill itself
    - On April 30, House Speaker Paul Ryan predicted the Bipartisan Banking Bill would become law within "a few weeks"

Complex Mix of Legislative and Regulatory Changes

Legislative Developments

- The Systemic Risk Designation Improvement Act (**SRDIA**) in its original form passed the full House in December 2016 but did not proceed further. A modified version was reintroduced in the new Congress in July 2017 by Rep. Luetkemeyer
- The Financial Regulatory Improvement Act of 2015 (**FRIA**) was introduced in June 2015 by former Senate Banking Committee Chair Richard Shelby
- House Speaker Paul Ryan's policy agenda, A Better Way (**Better Way**), was published in June 2016. In light of Speaker Ryan's announced retirement from the House later this year, however, it is uncertain whether and to what extent this policy agenda may progress before he leaves Congress or be adjusted after his successor is elected
- The Financial Institutions Bankruptcy Act (**FIBA**), which is based on the Hoover Institution's Chapter 14 proposal and would add a new Subchapter V to Chapter 11 of the Bankruptcy Code, was passed by the House in April 2017

Improving Supervision and the Regulatory Engagement Model

- **General Outlook:** Change likely in how regulators engage with the banking sector
  - The Treasury Banking Report includes several recommendations for an improved regulatory engagement model
  - Goals of mutual accountability and common understanding of responsibility between the banks and regulators
  - Will also review interagency guidance, such as policy statements, to update and streamline guidance
  - Vice Chair Quarles has said that "changing the tenor of supervision" will "be the biggest part" of what he will do as Vice Chair, "particularly in the early stages" of his tenure
  - In his April 17 testimony before the House Financial Services Committee, Vice Chair Quarles stated that "the regulation of [the financial] system should support and promote the system's efficiency just as it promotes its safety," and focused on a supervisory framework based on the three principles of efficiency, transparency and simplicity

For more information on improving the regulatory engagement model, please visit the Fin Reg blog – "*Davis Polk Comments on Federal Reserve's Proposed Guidance on Board Governance*" (Feb. 16, 2018), "*Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework*" (Jan 24, 2018), "*As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles*" (Jan. 23, 2018), *"Federal Reserve Proposes New Guidance on Management of Large Financial Institutions"* (Jan. 8, 2018), and *"Federal Reserve Proposes New Guidance on Corporate Governance* (August 7, 2017)

Improving Supervision and the Regulatory Engagement Model

- **Potential Methods of Change:**
  - The Treasury Banking Report recommends reassessing regulatory requirements on a banking organization's Board of Directors
    - Notes that duties imposed on Boards "lack appropriate tailoring and undermine the important distinction between the role of management and that of Boards"
      - The Federal Reserve proposed guidance in August 2017 that would rescind or revise some of the existing supervisory expectations for bank holding companies and that would clarify the role of the Board in addressing MRIAs and MRAs
    - Recommends an inter-agency review of the collective requirements imposed on Boards to tailor aggregate expectations and strike a better balance between Board and senior management responsibilities
  - Vice Chair Quarles has characterized the purpose of the August 2017 proposed guidance as intended to "scale back some of the excessive micromanagement" of boards
  - The Treasury Banking Report recommends that the independent financial regulatory agencies perform and make available a cost-benefit analysis for "economically significant" proposed regulations and strive to achieve greater consistency in their methodology and use of cost-benefit analysis
  - The Federal Reserve has established a new office that, according to Chair Powell, will "focus very particularly on cost-benefit analysis"
    - Vice Chair Quarles has asked his staff to conduct a comprehensive review of regulations related to capital, stress testing, liquidity and resolution in order to evaluate the costs and benefits of those regulations

For more information on improving the regulatory engagement model, please visit the Fin Reg blog – "Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework" (Jan 24, 2018) and "As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles" (Jan. 23, 2018)

Improving Supervision and the Regulatory Engagement Model

- **Potential Methods of Change:**
  - The Treasury Banking Report also recommends improvements to the process for remediating regulatory issues
    - Recommends an inter-agency reassessment of the volume of MRA, MRIAs and consent orders
    - Recommends that regulators and banks develop an improved approach to clearing regulatory actions to reduce multi-year delays
  - In December 2017, Former Chair Yellen stated that the Federal Reserve was "evaluating its general approach to issuing guidance" after the Government Accountability Office (**GAO**) determined that the 2013 Interagency Guidance on Leveraged Lending was a "rule" under the Congressional Review Act and so could not become effective until it was submitted to Congress
    - Before making its determination, the GAO sought comment from the OCC's Chief Counsel and the General Counsels of the Federal Reserve and the FDIC, each of whom insisted that the Interagency Guidance was not binding—this claim is difficult to credit, given public reports that the agencies had issued MRIAs and MRAs based on the Interagency Guidance
    - In late February 2018, Comptroller Otting stated that, with respect to leveraged lending, "you have the right to do what you want so long as it does not impair safety and soundness. It's not [the OCC's] position to challenge that"
  - Vice Chair Quarles has mentioned specifically that the Federal Reserve is revising the process for control determinations under the Bank Holding Company Act in order to make that process more transparent, simpler to understand, and easier to apply, including the codification of the determination framework and the liberalization of unspecified "existing limitations"

For more information on improving the regulatory engagement model, please visit the Fin Reg blog – "Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework" (Jan 24, 2018) and "As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles" (Jan. 23, 2018)

Federal Reserve Independence, Transparency and Structure

- **General Outlook:**
  - Moves to limit the Federal Reserve's monetary policy discretion and increase transparency seem to have faded into the background for now
  - Chair Powell, however, stated at his confirmation hearing that he is "strongly committed" to an independent Federal Reserve that conducts monetary policy "without a view to political outcomes"
    - Chair Powell also expressed support for the current institutional structure of the Federal Reserve with regard to the existence and participation of Federal Reserve Banks in monetary policy
  - Vice Chair Quarles has noted the need to "balance … two objectives – democratic accountability and independence around the monetary policy function"
- **Potential Methods of Change:**
  - The CHOICE Act would:
    - Limit the Federal Reserve's independence in many areas, including monetary policy
      - The Federal Reserve would be required to set federal funds rate, discount rate and rate on reserve requirements using Taylor Rules and explain deviations from reference formulas
    - Create a Centennial Monetary Commission charged with examining the role of the Federal Reserve as a central bank and its current dual mandate
    - Make all Federal Open Market Committee (**FOMC**) meetings recorded with a transcript made public—current custom is release after 5 years
    - Subject the Federal Reserve's and other agencies' rulemaking to explicit and stringent cost-benefit requirements, with major regulations requiring Congressional resolution to become effective

Federal Reserve Independence, Transparency and Structure

- **Potential Methods of Change:**
  - Earlier versions of the Dodd-Frank bill would have eliminated the Federal Reserve Banks
    - Private ownership of Federal Reserve Banks has been criticized
  - By contrast, the CHOICE Act would increase the number of Presidents of the Federal Reserve Banks on the FOMC from five to six and add a new requirement that nine vote in favor of any emergency lending under Section 13(3) of the Federal Reserve Act in order for that power to be usable
  - Better Way calls for:
    - Greater predictability of monetary policy and greater decision-making transparency
    - Subjecting the Federal Reserve's funding for prudential regulatory activities to Congressional appropriations process
  - FRIA would:
    - Establish commission to study possible restructuring of the Federal Reserve
    - Require submission of quarterly monetary policy reports to Congress by FOMC

Federal Reserve Independence, Transparency and Structure

- **Potential Methods of Change:**
  - The Monetary Policy Transparency and Accountability Act of 2017, introduced in the House by Congressman Andy Barr in November 2017, would require the Federal Reserve to annually select one primary instrument for implementing monetary policy, as well as 1-3 rules dictating how that monetary policy instrument should be used in reaction to changes in publicly available economic indicators. The Federal Reserve would maintain flexibility to deviate from the outcomes prescribed by its chosen instrument and rules
  - Treasury Secretary Mnuchin has signaled support for continued Federal Reserve independence, noting that it "is organized with sufficient independence to conduct monetary policy and open market operations" and that he "endorse[s] the increased transparency" that the Federal Reserve has provided in recent years
  - Vice Chair Quarles stated at his confirmation hearings: "I think the Taylor rule is merely one example of a rule and I'm not advocating adoption of that rule to guide Fed policy"

FSOC Structure and Authority

- **General Outlook**: Contrasting calls for decreased designation authority but a strengthened coordination role
  - Many Republicans in Congress favor significant FSOC organizational changes
    - The House Financial Services Committee's February 28, 2017 report entitled "The Arbitrary and Inconsistent FSOC Nonbank Designation Process" argued that the FSOC does not follow its own rules and guidance for the nonbank designation process and that the FSOC's analysis of companies is inconsistent and arbitrary
    - Better Way is highly critical of FSOC's politicized structure, lack of transparency and SIFI designation process
  - The Treasury FSOC Report makes it clear that the Treasury Department envisions both maintaining the current designation role for FSOC and expanding its coordination role:
    - FSOC should not limit its "broad discretion" in determining how to respond to potential threats to financial stability granted by the Dodd-Frank Act to only addressing risks at certain nonbank financial companies that may be designated
    - FSOC should prioritize activities-based or industry-wide risk identification, rather than singling out individual firms
  - The Treasury 2017 Annual Report maintains the Mnuchin Treasury's position that the FSOC should play a coordination role, as opposed to the view of House Republicans who would emasculate the FSOC
    - The FSOC's coordination role should reflect the newly identified risks of increased compliance costs and regulatory burdens for financial institutions as a potential threat to financial stability

For more information on FSOC, please visit the Fin Reg blog – "FSOC 2017 Annual Report—A Subtle Shift in Tone that Signals the Possibility of Meaningful Change" (December 21, 2017) and *"Treasury's Recommendation for FSOC: No CHOICE but to Play Double Duty"* (November 20, 2017)

FSOC Structure and Authority

- **Potential Methods of Change:**
  - The Treasury Banking Report recommends that Congress expand the FSOC's authority to play a larger role in the coordination and direction of regulatory and supervisory policies, including by giving it the power to appoint a lead regulator on issues on which multiple agencies may have conflicting and overlapping regulatory jurisdiction
  - The FSOC already has statutory authority to serve as a forum with name-and-shame powers to coordinate a change in policy, encourage action at a member agency and facilitate member agencies entering into memoranda of understanding
    - Former Acting Comptroller of the Currency Noreika has said that the new leadership changes at the heads of regulatory agencies are "a real opportunity for the bank regulators to get on the same page and further coordinate their actions," and there is a possibility of "a memorandum of understanding being entered into among the agencies so there is less regulatory duplication, and less so-called piling on"
  - AIG's SIFI designation was rescinded on September 29, 2017
  - The FSOC and MetLife, Inc. filed a joint motion on January 18, 2018 to dismiss the FSOC's appeal of the MetLife de-designation decision by the district court
  - Treasury Secretary Mnuchin announced in February 2018 that the FSOC will re-evaluate Prudential's SIFI designation in the near future
  - In October 2017, then-Director of the NEC Cohn publicly acknowledged bipartisan support for increasing the $50 billion asset threshold for SIFI designation to at least $200 billion
  - In April 2018, the House passed the FSOC Improvement Act, which would impose additional procedural requirements for nonbank SIFI designations, including requiring FSOC to reevaluate a non-bank SIFI's designation every five years upon request

For more information on FSOC, please visit the Fin Reg blog – "FSOC 2017 Annual Report—A Subtle Shift in Tone that Signals the Possibility of Meaningful Change" (December 21, 2017) and *"Treasury's Recommendation for FSOC: No CHOICE but to Play Double Duty"* (November 20, 2017)

FSOC Structure and Authority

- **Potential Methods of Change:**

Greater Role in Coordination	Reduced or Modified Role in SIFI Designation

The Treasury FSOC Report recommends:
▪ Expanding FSOC's coordination role while maintaining its current SIFI designation role
▪ Extending FSOC's power to activity and product regulation
 	
The Treasury Banking Report recommends:
▪ Expanded role in coordination and direction of regulatory and supervisory policies
  ▪ grant authority to appoint lead agency on any issue on which multiple agencies have overlapping jurisdiction
  ▪ reform FSOC to further facilitate information sharing and coordination among regulators
 	
The Treasury 2017 Annual Report recommends:
▪ Expanding FSOC's coordination role
▪ Focusing on activities-based regulation
▪ Taking into account compliance costs and regulatory burdens, overlap and tailoring
	The CHOICE Act would:
	▪ repeal authority to designate nonbank SIFIs
	▪ repeal authority to designate SIFMUs and systemically important payment, clearing and settlement activities
	▪ repeal authority to recommend heightened standards
	▪ enhance Congressional oversight
	
	SRDIA would:
	▪ replace automatic $50B threshold for non-G-SIB SIFI designation with Federal Reserve designation using indicator-based measure (requiring FSOC sign-off in certain cases)
	
	FRIA would:
	▪ replace automatic $50B-$500B designation with FSOC determination following prescribed procedures
	
	The FSOC Improvement Act would:
	• require FSOC to consider the appropriateness of prudential regulation in non-bank SIFI designations
	• enhance transparency in the non-bank SIFI designation process, including by providing an opportunity for periodic reevaluation

For more information on FSOC, please visit the Fin Reg blog – "FSOC 2017 Annual Report—A Subtle Shift in Tone that Signals the Possibility of Meaningful Change" (December 21, 2017) and "Treasury's Recommendation for FSOC: No CHOICE but to Play Double Duty" (November 20, 2017)

CFPB Structure and Authority

- **General Outlook:** Calls by Trump Administration, Acting Director Mulvaney and private sector for a decrease in CFPB's power through both reorganization and circumscribed authority with Democratic Senators having a very different view

	Proposals for Change			
	Treasury Banking Report	**CHOICE Act**	**CFPB April 2018 Semi-Annual Report**	**FRIA**
Structure	Retain single-director but director removable at will Alternatively restructure CFPB as multi-member commission*	Retain single-director structure but director removable at will	Ensure that the Director answers to the President in the exercise of executive authority**	
Funding	Subject funding to Congressional appropriations			
Rulemaking	Require CFPB to identify outdated or unnecessary requirements imposed on regulated entities	New rulemaking and enforcement actions subject to enhanced cost-benefit analysis	Require legislative approval of major CFPB rules**	
Supervision and Examination	Eliminate supervisory authority	Eliminate supervisory, examination and market-monitoring authorities Eliminate enforcement power over depository institutions		Raise examination threshold to $50B in assets
Enforcement	Require actions to be brought in federal district court instead of through administrative proceedings Require newly-issued rules and guidance be subject to public notice and comment before bringing enforcement actions in areas where clear guidance is lacking	Permit respondent to compel CFPB to bring civil action in federal court instead of an administrative proceeding		
UDAAP	Require more clearly defined UDAAP interpretations and notice to regulated entities before monetary sanctions permitted	Eliminate CFPB's UDAAP authority and require the FDIC, OCC, Federal Reserve and NCUA to regulate and enforce UDAP (does not include "abusive" acts or practices)		
Consumer Complaint Database	No public access	No public access		

**Senators Schumer, Brown, and Warren reject the idea of a commission*

***The April 2018 Semi-Annual Report does not provide additional details*

CFPB Structure and Authority

- **Leadership at the CFPB:**
  - Richard Cordray resigned as CFPB director on November 24, 2017 and President Trump appointed OMB Director Mick Mulvaney as CFPB Acting Director under the authority granted to him by the Federal Vacancies Reform Act of 1998 (**FVRA**)
  - Since assuming the role, Acting Director Mulvaney has made his mark on the CFPB by, among other things, issuing a memo reorienting the CFPB's mission based on the rule of law; announcing a call for evidence seeking public comment on the CFPB's activities; announcing the CFPB's intent to reconsider its payday rule; and dropping pending lawsuits and enforcement actions initiated under prior CFPB leadership
  - It is uncertain how much longer Acting Director Mulvaney will remain at the CFPB
    - On January 10, 2018 the U.S. District Court in Washington, D.C. denied Deputy Director Leandra English's request for a preliminary injunction to prevent Mulvaney from serving as Acting Director. Two weeks later, however, the D.C. Circuit granted English's motion for an expedited appeal; oral argument was heard on April 12, 2018
    - Under the FVRA, in the absence of the President nominating a permanent appointee, acting appointees may generally serve for "no longer than 210 days beginning on the date the vacancy occurs." Once the President nominates a permanent appointee, however, the acting appointee may continue to serve while that nomination is pending. If that nomination is rejected, withdrawn, or returned to the President, the acting appointee may serve for an additional 210 days from the point of such rejection, withdrawal or return, and additional extensions apply if and when a second nomination is made
    - If Acting Director Mulvaney's tenure is not cut short by the D.C. Circuit and President Trump nominates a permanent CFPB Director by mid-to-late June, Acting Director Mulvaney could remain at the CFPB through 2018, or even longer
- ***PHH v. CFPB*:**
  - An *en banc* D.C. Circuit ruled 7-3 on January 31st that the CFPB's current structure is constitutional, and PHH Corporation did not file a petition for Supreme Court review by the May 1 deadline; the next steps in the wake of the *PHH* decision are uncertain

For more information on CFPB reform, please visit the Fin Reg blog – "D.C. Circuit Decides PHH v. CFPB—Is the Supreme Court Next?" (Feb. 2, 2018); "The CFPB and the Rule of Law" (Jan. 27, 2018) and The CFPB's Call for Evidence: An Indication of Further Regulatory Rebalancing" (Jan. 19, 2018)

CFPB Structure and Authority

- **Acting Director Mulvaney's Call for Evidence**
  - On January 17, Acting Director Mulvaney announced that the CFPB would "critically examine its policies and practices to ensure they align with the [CFPB's] statutory mandate," including by issuing a series of Requests for Information (**RFIs**) seeking public comment on the way the CFPB currently conducts its activities. The CFPB issued subsequent RFIs on:
    - Civil investigate demands; administrative adjudications; enforcement processes; supervisory processes; external engagements; consumer complaint reporting; rulemaking processes; rules adopted by the CFPB; rules inherited by the CFPB (i.e., those rules for which the Dodd-Frank Act transferred authority to the CFPB); guidance and implementation support; consumer financial education; and consumer inquiries
- **CFPB Semi-Annual Report**
  - The CFPB's spring 2018 semi-annual report, the first issued under Acting Director Mulvaney, includes a request that Congress make four changes to the law in order to establish meaningful CFPB accountability:
    - Fund the CFPB through Congressional appropriations
    - Require legislative approval of major CFPB rules
    - Ensure that the Director answers to the President in the exercise of executive authority
    - Create an independent CFPB Inspector General
  - Acting Director Mulvaney's testimony before Congress in mid-April 2018 reiterated these four requests

For more information on the CFPB's RFIs, please visit the Fin Reg blog –"The CFPB's Call for Evidence: An Indication of Further Regulatory Rebalancing" (Jan. 19, 2018)

Tailored Regulation by Size and Business Model

- **General Outlook**: The Bipartisan Banking Bill would implement the strong consensus that regulation should be tailored to a banking organization's business model and risk profile by raising many existing asset size thresholds
  - The bill is now being considered in the House, where Rep. Hensarling has recently tempered his previous comments stating a strong preference to introduce amendments to the Senate's careful bipartisan compromise and where Speaker Ryan has said the bill may become law within "a few weeks"
- **Potential Methods of Change:**
  - The Bipartisan Banking Bill would tailor many regulatory requirements based on asset size or business model
    - Most notably, it would raise the statutory threshold from $50 billion to $250 billion in total consolidated assets for many of the Federal Reserve's enhanced prudential standards (**EPS**), including resolution planning, DFAST company-run stress testing, liquidity stress testing and buffer requirements, and single-counterparty credit limits (**SCCL**). The bill would, however, allow the Federal Reserve to raise or lower this threshold in certain circumstances
  - The SRDIA, which passed the House in December, would, alternatively, eliminate the thresholds for EPS and other Dodd-Frank Act requirements and instead apply these requirements to all G-SIBs and any other institutions designated for this treatment by the Federal Reserve (and, in some cases, FSOC)
  - At his confirmation hearing, Chair Powell indicated his support for the Bipartisan Banking Bill and for tailoring regulation through asset size thresholds, as opposed to or in conjunction with allowing federal regulators to designate firms for regulation on a discretionary basis
  - Vice Chair Quarles stated in his ABA Banking Law Committee remarks that, regardless of whether Congress raises any statutory thresholds, the Federal Reserve and other financial regulatory agencies should tailor their requirements through rulemaking
    - Vice Chair Quarles specifically advocated amending the LCR and DFAST company-run stress test rules to distinguish between G-SIBs and large non-G-SIBs

For more information on how the Bipartisan Banking Bill would affect banking organizations, please visit the Fin Reg blog – "Visual Memorandum: Senate Bipartisan Banking Bill to Rebalance the Financial Regulatory Landscape" (March 28, 2018), "Senate Bipartisan Banking Bill Offers Relief from Stress Testing, Capital and Liquidity Requirements" (March 16, 2018), "Senate Passes the Bipartisan Banking Bill" (March 15, 2018), "Bipartisan Senate Bill Advances from Committee Largely Unchanged" (December 7, 2017) "Left Out in the Cold? The Bipartisan Senate Bill and G-SIBs, Other Large Banks and Foreign Banks" (November 27, 2017) and "Bipartisan Senate Bill Would Provide Welcome Relief to Regional and Community Banks" (November 20, 2017). For more information on Vice Chair Quarles speech, please visit the Fin Reg blog – "Federal Reserve May Simplify the TLAC Rule" (January 30, 2018), "Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework" (January 24, 2018) and "As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles" (January 23, 2018)

Tailored Regulation by Size and Business Model

- The Bipartisan Banking Bill would tailor existing regulations in the following ways, depending upon the size of an institution:

$250+ Billion and G-SIBs	• Would still be subject to all existing EPS under revised threshold • G-SIBs with less than $250 billion in total assets would be deemed to have $250 billion or more in total assets • The Federal Reserve would be able to establish asset size thresholds above $250 billion for EPS relating to contingent capital, resolution plans, credit exposure reports, SCCL, enhanced public disclosures and short-term debt limits
$100 to $250 Billion	• Would be exempt from most EPS (but not the risk committee and DFAST supervisory stress testing requirements), 18 months after bill is enacted • The Federal Reserve would be able to apply any of the EPS to any BHC in this range, provided that the Federal Reserve has determined that doing so is appropriate to address financial stability risks or safety and soundness concerns and has taken into consideration the BHC's capital structure, riskiness, complexity and other factors
$50 to $100 Billion	• Would immediately be exempt from almost all EPS (but not the risk committee requirement) upon the bill being enacted

< $50 Billion	• Institutions with $10 to $50 billion in total assets:
	  • Would be exempt from company-run stress testing immediately
	  • Would not be required by statute to have a risk committee, and the Federal Reserve could maintain or eliminate this requirement
	• Would require the U.S. banking agencies to establish a limited regulatory off-ramp for community banks that opt into compliance with a new, simple leverage ratio, as described in the capital and liquidity section of this deck
	• Any BHC that has $10 billion or less in total assets and total trading assets and trading liabilities of 5% or less of assets would be exempt from the Volcker Rule
	• Would increase the applicable asset size threshold for:
	  • The Federal Reserve's Small Bank Holding Company and Savings and Loan Holding Company Policy from $1 billion to $3 billion in total assets
	  • Extended examination cycles for eligible well-capitalized and well-managed IDIs from $1 billion to $3 billion in total assets
	• Would require the U.S. banking agencies to reduce the reporting requirements for first and third quarter call reports of certain IDIs with less than $5 billion in total assets

Tailored Regulation by Size and Business Model

- The Bipartisan Banking Bill would also provide other targeted relief, including the following, which are explained in further detail in the capital and liquidity section of this deck:
  - Require the U.S. banking agencies to liberalize the treatment of certain municipal securities under the liquidity coverage ratio (**LCR**)
  - Exclude certain central bank deposits from the supplemental leverage ratio (**SLR**) denominator for custody banks
  - Decrease the frequency of and number of economic scenarios under the Dodd-Frank Act stress tests
  - Override the U.S. banking agencies' higher risk weights for certain higher-risk commercial real estate exposures
- **Impact on CCAR?**
  - While the changes proposed in the Bipartisan Banking Bill would technically apply to the DFAST stress testing requirements and not the Federal Reserve's CCAR capital planning framework, we believe the Federal Reserve would take a similar approach in terms of making corresponding changes to its capital planning regulations
- **Treatment of FBOs**
  - The Bipartisan Banking Bill clarifies that nothing in the relevant provision would:
    - Affect the application of the Federal Reserve's existing EPS regulations to an FBO with $100 billion or more in global total consolidated assets
    - Limit the authority of the Federal Reserve to implement EPS with respect to, require the establishment of an IHC under, or tailor the regulation of an FBO with $100 billion or more in global total consolidated assets

For more information on how the Bipartisan Banking Bill would affect banking organizations, please visit the Fin Reg blog – "Visual Memorandum: Senate Bipartisan Banking Bill to Rebalance the Financial Regulatory Landscape" (March 28, 2018), "Senate Bipartisan Banking Bill Offers Relief from Stress Testing, Capital and Liquidity Requirements" (March 16, 2018) and "Senate Passes the Bipartisan Banking Bill" (March 15, 2018)

Tailored Regulation by Size and Business Model

- **Treasury Banking Report:**
  - The Treasury Banking Report also sets forth as one of its five overall themes the tailoring of regulations based on size and complexity of regulated firms and makes specific proposals related to tailoring:

Thresholds and Off-ramp	• Raise $50B EPS threshold to more appropriately tailor EPS to risk profile and complexity of a BHC and use same threshold for other requirements (see below) • Soft support for the CHOICE Act off-ramp concept or the general principle of off-ramps
Capital, Liquidity, Stress Testing and Volcker Rule:	• Several tailoring recommendations made in these areas, which are explained in further detail in the related slides
SCCL	• Raise threshold to match EPS threshold
Living Wills	• Raise threshold to match EPS threshold
Board of Directors' Duties	• Reassess regulatory requirements on a bank's board of directors to tailor duties to maintain distinction between management and boards and allow boards greater time to oversee business risk and strategy • The Federal Reserve has proposed guidance revising some of the supervisory expectations for Boards
FBOs	• Increase thresholds for EPS and CCAR to match thresholds for U.S. entities, basing application on FBOs' U.S. risk profile rather than global assets

For more information on the Treasury Banking Report, please visit the Fin Reg blog – "Davis Polk Visual Memo on Treasury Report's Capital, Stress Testing and Liquidity Recommendations, and Initial Agency Responses" (July 17, 2017) and "Treasury Publishes First Report on Banking Regulations" (June 12, 2017)

Tailored Regulation by Size and Business Model

- **Some Change Is Already Occurring:**
  - As discussed in further detail in the Capital, Liquidity and Stress Testing section:
    - On April 11, 2018, the Federal Reserve and the OCC issued a joint proposed rule intended to tailor G-SIBs' enhanced supplementary leverage ratio requirements to those firms' individual risk characteristics
    - On April 10, 2018, the Federal Reserve issued a proposed rule that would make certain changes to CCAR and the capital rules (including the introduction of a new stress capital buffer calculation based on prior CCAR results)
      - According to the accompanying Staff memo, the proposal would effectively lower the CET1 capital requirements for "most" non-G-SIBs" and "generally maintain or in some cases increase" the corresponding capital requirements for G-SIBs
      - That memo further states that one goal of the proposal is to "ensure that the regime is further tailored to the size, complexity and systemic footprint of each bank holding company subject to CCAR"
  - In March 2017, the Federal Reserve raised the asset thresholds indicating presumptive financial stability concerns in banking M&A transactions
  - In January 2017, the Federal Reserve removed the qualitative assessment under CCAR for non-G-SIB banking organizations with total assets between $50 billion and $250 billion and less than $75 billion in total nonbank assets—a category including all assets of and parent equity investments in nonbank subsidiaries; this relief should apply to most regional banking organizations

For more information on the U.S. banking agencies' proposed rules to simplify certain capital rules please visit the Fin Reg blog – "House of Representatives Passes Bill to Address Calculation of Operational Risk RWAs Under U.S. Basel III" (March 12, 2018), "Banking Agencies Propose to Simplify U.S. Basel III Capital Rules for Non-Advanced Approaches Firm" (September 29, 2017). For more information on the Federal Reserve's final rule to indefinitely delay the phase-in of certain provisions of the capital rules, please visit the Fin Reg blog – "U.S. Banking Agencies Delay the Phase-In of Certain Capital Rules for Non-Advanced Approaches Banking Organizations" (November 21, 2017). For more information on the Federal Reserve's decision to raise the asset thresholds indicating presumptive financial stability concerns, please visit the Fin Reg blog – "A Modest Yet Welcome Thaw for Banking M&A and Financial Stability" (March 18, 2017)

Capital, Liquidity and Stress Testing

- **General Outlook:** U.S. banking agencies have unfinished business in implementing or finalizing U.S. Basel III capital and liquidity requirements, but Vice Chair Quarles has signaled that intention is not to weaken capital, liquidity or stress-testing requirements
  - **Capital**
    - Implementation of Stress Buffer Requirements (**SBR**) – proposed April 2018 (see next page)
    - Recalibration of enhanced SLR (**eSLR**) – proposed April 2018 (see next page)
    - Capital treatment of Current Expected Credit Losses methodology (**CECL**) – proposed 2018

Capital Standards Finalized by Basel Committee but Not Yet Implemented in the United States	
▪ Fundamental Review of the Trading Book (**FRTB**) ▪ Standardized Approach for Counterparty Credit Risk (**SA-CCR**) ▪ Interest Rate Risk in the Banking Book (**IRBB**) ▪ Revised Securitization Framework ▪ Revised Treatment of Investment Funds ▪ Standardized Measure for Operational Risk	▪ Basel Committee released finalized revisions to the Basel III capital standards in December 2017 ▪ Capital Floors for Credit Risk ▪ Unclear how Basel Committee capital floor standard would be implemented in the United States in light of the Collins Amendment, which effectively imposes 100% of standardized RWAs as a floor

  - **Liquidity**
    - Net Stable Funding Ratio (**NSFR**) – proposed June 2016
    - LCR for FBO IHCs?
  - **Stress Testing and Capital Planning (DFAST and CCAR)**
    - Federal Reserve released a set of proposals in December 2017 aimed at increasing transparency of its stress testing (**DFAST**) and capital planning (**CCAR**) programs, which would release greater information about the models it uses to estimate hypothetical losses for purposes of DFAST and CCAR
    - SBR proposal would also change certain CCAR and DFAST assumptions that would result in reduced capital requirements for most banks participating in CCAR

Capital, Liquidity and Stress Testing

- **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 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 stress capital buffer
    - The SBR proposal would also modify several assumptions in the CCAR process to better align them with a firm's expected actions under stress, including a constant rather than growing balance sheet
  - **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 recent 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 TLAC and long-term debt requirements for U.S. G-SIBs
    - Vice Chair Quarles stated in his April testimony to the House Financial Services Committee that the objective of eSLR calibration is to make sure that eSLR is not a primary binding capital measure
  - **CECL Methodology**: In April 2018, the FDIC, Federal Reserve and OCC released a proposed rule on the effects of a banking organization's adoption of the CECL methodology on regulatory capital and stress testing

Capital, Liquidity and Stress Testing

- The Bipartisan Banking Bill would make the following changes to the U.S. Basel III capital and liquidity rules:
  - **Treatment of Municipal Securities under the LCR:** The U.S. banking agencies would be required to amend the LCR to expand the eligibility of investment grade municipal obligations as Level 2B high-quality liquid assets
  - **SLR for Custody Banks:** The bill would direct 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
    - Central bank reserves of custody banks would be excluded only to the extent of the value of customer deposits that are linked to fiduciary, custody or safekeeping accounts
    - Vice Chair Quarles noted in Congressional testimony that only the three custody banks will benefit from this provision because it is limited to banks that are "predominantly" engaged in custodial services.
  - **Community Bank Leverage Ratio / Off Ramp:** The U.S. banking agencies would be directed to establish via rulemaking a community bank leverage ratio, and banking organizations that exceed this leverage ratio would 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
    - A bank or BHC would qualify for the community bank leverage ratio if the bank or BHC has total consolidated assets of less than $10 billion
    - The community bank leverage ratio would be defined as the ratio of a banking organization's tangible equity capital to its average total consolidated assets and would be set between 8% and 10%
  - **Capital Treatment of Commercial Real Estate Exposures:** The bill would also change the capital treatment of high volatility commercial real estate (**HVCRE**) exposures, preventing the U.S. banking agencies from applying a heightened, 150% risk weight to an HVCRE exposure unless the exposure also falls within the definition of an **HVCRE ADC loan**, as newly defined in the bill. This change would:
    - Effectively create a specific statutory capital regulation requiring the U.S. banking agencies to align their rules with the new HVCRE ADC loan definition
    - Prevent the U.S. banking agencies from amending the capital treatment of commercial real estate exposures for non-advanced approaches banking organizations – which they proposed to do in September 2017

Capital, Liquidity and Stress Testing

- The Bipartisan Banking Bill would make the following changes to the DFAST stress testing requirements:
  - **Thresholds and Frequency of DFAST Company-Run Stress Tests:**
    - G-SIBs, BHCs, SLHCs, banks and savings associations with total consolidated assets of at least $250 billion would be subject to periodic, as opposed to annual, company-run stress tests
    - The Federal Reserve could designate a BHC with $100 billion to $250 billion in total consolidated assets to be subject to company-run stress tests
    - BHCs with total consolidated assets of less than $100 billion would be exempt from company-run stress tests
  - **Thresholds and Frequency of DFAST Supervisory Stress Tests:**
    - G-SIBs and BHCs with total consolidated assets of at least $250 billion would still be subject to annual supervisory stress tests
    - BHCs with $100 billion to $250 billion in total consolidated assets (except any G-SIBs in this asset range) would be subject to periodic, rather than annual, supervisory stress tests
      - The Federal Reserve could designate a BHC with $100 billion to $250 billion in total consolidated assets to be subject to the annual supervisory stress test requirements applicable to G-SIBs and larger BHCs
    - BHCs with total consolidated assets of less than $100 billion would be exempt from supervisory stress tests
  - **Number of Dodd-Frank Act Stress Test Economic Scenarios:** The bill would also reduce the required number of economic scenarios from three to two, eliminating the middle-of-the-road adverse scenario and leaving the baseline and severely adverse scenarios
  - **Impact on CCAR?** Although the Bipartisan Banking Bill would not directly change the Federal Reserve's CCAR requirements, we believe the Federal Reserve would make similar changes to the thresholds and scenario requirements for its CCAR rules

Capital, Liquidity and Stress Testing

- The Treasury Banking Report also recommends that capital, stress testing and liquidity requirements should be appropriately tailored, calibrated and simplified in order to avoid unnecessary duplication and to better work in concert with resolution planning and other EPS
  - This would include a recalibration of buffers and the SLR, adjustments to risk weighted assets and tailoring of capital, stress testing and liquidity rules
  - The Treasury Banking Report also recommends delay and reassessment of the FRTB and NSFR
  - These recommendations would extend significant relief to a broad range of financial institutions from G-SIBs to community banks, including FBO IHCs
- The CHOICE Act would allow banking organizations to opt into a lighter regulatory regime, provided they maintain relatively high leverage capital ratios (SLR for most large BHCs)
  - The Treasury Banking Report referred to an “off-ramp” exemption as an alternative approach to be considered
- In February 2018, the House passed H.R. 4296, which would place limitations on any operational risk capital requirement adopted by a U.S. banking agency, including by providing that any such requirement must be (1) based primarily on the risks posed by the banking organization’s current activities and business (as opposed to discontinued activities) and (2) appropriately sensitive to the risks posed by such current activities and businesses
- In September 2017, the U.S. banking agencies proposed rules to simplify certain aspects of the capital rules, primarily for non-advanced approaches banking organizations
  - This proposal includes revisions to the HVCRE framework that are at odds with, and would be overridden by, the Bipartisan Banking Bill
  - In November, in keeping with the simplification proposal, the U.S. banking agencies finalized a rule to indefinitely delay, for non-advanced approaches banking organizations, the final phase-in step for certain provisions of the capital rules that would be affected by the simplification proposal

U.S. IHCs of FBOs and EPS Applicable to FBOs

- **General Outlook:** The Bipartisan Banking Bill would provide regulatory relief to FBOs under certain asset thresholds; the Treasury Banking Report recommends changes that would provide regulatory relief to nearly all FBOs now subject to EPS requirements, and it hints at a more dramatic shift to restoring the United States' traditional application of the principle of national treatment and limits on extraterritorial regulation of FBOs
- **Potential Methods of Change:**
  - The Bipartisan Banking Bill would increase the statutory threshold for most of the Federal Reserve's EPS to $250 billion in total consolidated assets. Earlier versions of the bill were silent as to which asset measure would be used for determining whether an FBO falls under this threshold – e.g., would the asset threshold be evaluated based on an FBO's global assets, combined U.S. assets or U.S. non-branch assets? As passed by the Senate, the bill clarifies that nothing in the relevant provision would:
    - Affect the application of the Federal Reserve's existing EPS regulations to an FBO with $100 billion or more in global total consolidated assets
    - Limit the authority of the Federal Reserve to implement EPS with respect to, require the establishment of an IHC under, or tailor the regulation of an FBO with $100 billion or more in global total consolidated assets
  - The Treasury Banking Report recommends:
    - Increasing the thresholds at which EPS apply to an FBO's U.S. operations and basing these thresholds on the FBO's U.S. risk profile, rather than its global consolidated assets
    - Increasing the threshold at which an FBO's U.S. IHC becomes subject to the CCAR process
    - Recalibrating EPS, such as liquidity and resolution planning requirements, to give greater weight to comparable home-country regulations and allowing for substituted compliance where home-country regulations are sufficiently comparable
    - 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
  - Some Treasury Banking Report recommendations could be effected by the Federal Reserve through revisions of its regulations (e.g., its CCAR and TLAC rules), while others would require statutory changes to Section 165 of the Dodd-Frank Act
  - Vice Chair Quarles has stated that the Federal Reserve will continue to exercise its authority to apply the EPS to FBOs in a flexible manner where appropriate to accommodate differences in firms' structures and risk profiles
  - EU proposal to require U.S. banking organizations to set up EU IHCs does not bode well for elimination of the U.S. IHC requirement, and the Treasury Banking Report specifically supports continuation of the requirement

Orderly Liquidation Authority

- **General Outlook:** Risk of being replaced by Bankruptcy Code alternative, but reform seems more likely than repeal
  - In February 2018, the Treasury Department issued a long-awaited report in which it recommended significantly reforming—but not repealing—OLA, while also recommending 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"
  - In November 2017, Chair Powell commented during his confirmation hearing that bankruptcy may not be sufficient to protect the economic health of the country under extreme stress conditions and a "backup in the form of something like [OLA]" is needed
  - In May 2017, nearly 125 financial scholars co-signed a letter opposing the repeal of OLA
    - The letter argued that bankruptcy is unable to provide a sufficient response to, and necessary planning for, the systemic risks that would be caused by a failure of a G-SIB
  - Members of the European Parliament also met with Federal Reserve officials during the week of July 21, 2017, and pressured the U.S. to preserve OLA
    - In explaining its recommendation to retain OLA in its February 2018 report, Treasury cited foreign regulators' concerns about "exclusive reliance on bankruptcy to resolve a U.S. financial company"

For more information on the Treasury's OLA report, please visit the Fin Reg blog – "Treasury: Retain but Reform OLA + Add New Chapter 14 to Bankruptcy Code" (Feb. 22, 2018)

Orderly Liquidation Authority

- **Potential Methods of Change:**
  - The CHOICE Act would replace OLA with a new Subchapter V of Chapter 11 (aka **Chapter 14**) to the Bankruptcy Code, which would be substantially similar to the FIBA, a bill that has passed the full House of Representatives twice
    - 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
    - The Treasury OLA Report recommends that Chapter 14 be added as a preferred alternative to OLA, not a replacement
  - The repeal of the Orderly Liquidation Fund (**OLF**) provisions of OLA and possibly all of OLA itself could be attached to a budget reconciliation bill, which would require only 51 votes in the Senate to be passed
  - A more modest alternative would be to amend OLA to impose severe limits on the FDIC's discretion, including its discretion to use the OLF for anything other than secured loans at premium rates; the Treasury OLA Report on OLA recommends such reforms
  - The FDIC could issue additional guidance or regulations to clarify certain aspects of OLA, even absent a statutory change

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

- **General Outlook:** The Treasury Banking Report supports the concept of actionable living wills but recommends modifications to ease the burden imposed on firms, in light of the policy goals of resolution planning
- **Potential Methods of Change:**
  - Many proposals would impact Section 165(d) living wills but not impact the separate IDI solo rule
  - The Bipartisan Banking Bill would raise the total consolidated asset threshold for Section 165(d) living wills from $50 billion to $250 billion and would authorize the Federal Reserve to raise or lower the threshold in certain circumstances
  - The Treasury Banking Report recommends that the agencies change the living wills process by moving to a two-year cycle, raising the $50 billion threshold through an FSOC recommendation, subjecting the living wills guidance and assessment framework to public notice and comment and requiring feedback on living wills within six months
    - Chair Powell and Vice Chair Quarles and FDIC Chair Gruenberg have expressed support for a two-year cycle; Vice Chair Quarles reiterated this support in his written statement submitted in advance of his April 17 testimony before the House Financial Services Committee
    - Vice Chair Quarles has expressed support for reducing the resolution planning burden on firms with less systemic footprints
    - The Federal Reserve and FDIC extended the deadline for the U.S. G-SIBs' next 165(d) filing to July 1, 2019 and did not identify any deficiencies in any of the U.S. G-SIBs 2017 165(d) plans
  - The Treasury Banking Report also recommends that the FDIC be removed from the Section 165(d) living will process and the CHOICE Act also would effect this change
    - The proposed removal of the FDIC may be linked to the proposed elimination of OLA
    - An alternative would be to eliminate the duplicative IDI solo rule, but the Treasury Banking Report does not make this recommendation and neither the Bipartisan Banking Bill nor the CHOICE Act would eliminate the IDI solo rule

Living Wills

- **Potential Methods of Change:**
  - The CHOICE Act would make many of the changes recommended in the Treasury Banking Report, including parallel changes to the IDI solo rule, except that banking organizations that qualified for the off-ramp would be exempt from the living will requirement, while non-qualifying banking organizations with $50 billion or more in consolidated assets would continue to be subject to the living will requirement
  - The Financial Institution Living Will Improvement Act, which passed the House in January 2018 with unanimous support, would also make many of the changes recommended in the Treasury Banking Report, including moving to a two-year submission cycle and requiring feedback on submissions within six months
  - Vice Chair Quarles has stated that he supports reducing the information burden on "firms with less significant systemic footprints" in connection with the living wills process

Derivatives

- **General Outlook:** OTC derivatives regime unlikely to change significantly
- **Potential Methods of Change:**
  - Key elements of regulation of OTC derivatives would remain in place under legislative proposals, including the CHOICE Act
  - Change of commissioners may lead to changes at the regulatory level through rulemaking priorities, changes in new rules, guidance and no-action letters
    - CFTC Chair Giancarlo, Commissioners Behnam and Quintenz have been confirmed
    - Dawn DeBerry Stump has been nominated, but not yet confirmed
    - CFTC has already started this process by:
      - Launching Project KISS (**Keep it Simple, Stupid**), an agency-wide internal review focused on simplifying and modernizing CFTC rules, regulations and practices, and issuing a related request for public input
      - Initiating a comprehensive review of the CFTC's swap data reporting regulations
      - Establishing LabCFTC, an initiative aimed at promoting responsible fintech innovation
      - Issuing determinations finding that the EU and Japanese margin requirements for uncleared OTC derivatives are comparable to the CFTC's uncleared swap margin rules
      - Issuing an order providing that the current swap dealer *de minimis* threshold ($8 billion notional of dealing swaps) will remain in place until December 31, 2019
  - In April 2018, the CFTC issued its "Swaps Regulation Version 2.0 – An Assessment of the Current Implementation of Reform and Next Steps" white paper, representing a roadmap for the agency's regulatory reform goals, which include reframing current regulations relating to:
    - Swap central counterparties
    - Swap reporting rules
    - Swap execution rules
    - Swap dealer capital; and
    - The end-user exception

For information on derivatives, please visit the Fin Reg blog – "CFTC Chairman Giancarlo's White Paper on Swap Regulation Reform Envisions Near-Term Changes and Longer-Term Enhancements" (May 4, 2018), *"CFTC Chairman Requests Additional Year to Evaluate the Swap Dealer De Minimis Threshold"* (Oct. 11, 2017), *"Key Takeaways from CFTC Enforcement Director's Speech and Q&A on Self-Reporting"* (Oct. 2, 2017), *"New CFTC Enforcement Director Emphasizes Benefits of Self-Reporting" (Sept. 11, 2017), "CFTC Begins Review of Swap Reporting Rules with a Welcome Focus on Simplification and Regulatory Coordination" (July 11, 2017), "The Giancarlo Agenda: The CFTC Gets Back to the Basics" (Mar. 17, 2017) and "Possible Priorities for a CFTC Chaired by Commissioner Giancarlo" (Jan. 6, 2017)*

Derivatives

- **Potential Methods of Change:**
  - The Treasury Capital Markets Report makes a number of recommendations for significant reforms to the Title VII OTC derivatives regime and reiterates common themes in the Title VII area, including unnecessarily onerous regulatory requirements, overreaching cross-border application of U.S. rules and lack of coordination between the CFTC and SEC
  - Key recommendations in the Treasury Capital Markets Report include:
    - Adoption of an interaffiliate exemption from IM requirements for prudentially-regulated swap dealers, harmonization of international margin requirements and adoption of other incremental changes to the uncleared swap margin rules that would provide relief on key operational challenges;
    - Reliance on greater deference to non-U.S. regulatory regimes and implementation of an outcomes-based substituted compliance regime;
    - Maintenance of the swap dealer de minimis registration threshold at $8 billion;
    - Reconsideration of whether transaction-level requirements should apply to transactions between non-U.S. firms that are arranged, negotiated or executed by U.S. personnel;
    - Adoption of swap trading rule changes to provide additional flexibility in the manner in which swaps are executed;
    - Improvement of swap reporting requirements and processes in line with the CFTC's Roadmap;
    - Resolution of unnecessary inconsistencies and duplication between swap and security-based swap rules, including granting interagency substituted compliance for any areas where effective harmonization is not feasible; and
    - Holistic review of guidance and relief provided by the CFTC and SEC over the past several years, with the aim of formalizing such relief into rulemaking

For information on derivatives, please visit the Fin Reg blog – "CFTC Chairman Giancarlo's White Paper on Swap Regulation Reform Envisions Near-Term Changes and Longer-Term Enhancements" (May 4, 2018), *"CFTC Chairman Requests Additional Year to Evaluate the Swap Dealer De Minimis Threshold"* (Oct. 11, 2017), *"Key Takeaways from CFTC Enforcement Director's Speech and Q&A on Self-Reporting"* (Oct. 2, 2017), *"New CFTC Enforcement Director Emphasizes Benefits of Self-Reporting" (Sept. 11, 2017), "CFTC Begins Review of Swap Reporting Rules with a Welcome Focus on Simplification and Regulatory Coordination" (July 11, 2017), "The Giancarlo Agenda: The CFTC Gets Back to the Basics" (Mar. 17, 2017) and "Possible Priorities for a CFTC Chaired by Commissioner Giancarlo" (Jan. 6, 2017)*

Volcker Rule

- **General Outlook:** Likely to be changed by regulation or legislation or both; full repeal unlikely
  - Strong consensus among policymakers that change is needed
    - Treasury Secretary Mnuchin, Former Chair Yellen, Chair Powell, Vice Chair Quarles and Former Acting Comptroller Noreika have all criticized the Volcker Rule as being too complex and have advocated for revisions to the regulations
    - Federal Reserve staff paper concluded that the Volcker Rule has had a "deleterious effect on corporate bond liquidity and dealers subject to the Rule become less willing to provide liquidity during stress times"
    - In testimony before the House Financial Services Committee on April 17, 2018, Vice Chair Quarles stated that "the Volcker Rule, as it has been implemented … isn't working well … creates uncertainty [and] it's not really an effective implementation of the statutory requirements." He went on to state that it is "unarguable" that the Volcker Rule is detrimental to capital markets and creates excessive burdens
  - Many industry groups responded to the OCC's August 2, 2017, request for information on potential changes to the Volcker Rule regulations
  - The OCC circulated a blueprint for Volcker Rule reform to the other regulators based on recommendations in the Treasury Banking Report
  - According to some media accounts, political and regulatory support for moderation of the Volcker Rule may be less forthcoming, based on actions by certain large financial institutions to curtail their business arrangements with firearms companies
  - Comptroller Otting stated in late April that a joint agency proposal to simplify the Volcker Rule will be published in mid-May

For more information on the Volcker Rule's future, please visit the Fin Reg blog – "Treasury Asset Management and Insurance Report Makes Three Recommendations Tied to the Volcker Rule (Oct. 30, 2017), "Volcker Rule Commenters Largely Support Reforms" (Oct. 11, 2017), "OCC Seeks Input on Volcker Regulation Reforms" (Aug. 2, 2017), "Green Shoots for the Volcker Rule: a Thaw in the Guidance Freeze?" (July 25, 2017), "Federal Banking Agencies Recognize Unintended Consequences of Volcker Rule for Foreign Banks and Propose Temporary Solution" (July 21, 2017) and "Federal Reserve Releases Staff Paper on the Impact of the Volcker Rule" (Jan. 5, 2017)

Volcker Rule

- **Potential Methods of Change:**
  - Softening the regulations would likely take at least 18 months from the time that a proposal is published and would require five agencies to agree
  - The Bipartisan Banking Bill would exempt a community bank that does not have, and is not controlled by a company that has, over $10 billion in total consolidated assets and total trading assets and trading liabilities of more than 5% of total consolidated assets
  - On April 13, 2018, the House passed the Volcker Rule Regulatory Harmonization Act, which would amend the Volcker Rule to give the Federal Reserve sole rulemaking authority and to exclude community banks from the Volcker Rule's requirements
  - The Treasury Banking Report recommends:
    - Exempting small banking organizations from the Rule entirely and permitting well-capitalized banking entities to opt out of the Rule altogether
    - Simplifying the proprietary trading definition by removing the 60-day rebuttable presumption
    - Revising the RENTD requirements
    - Narrowing the definition of covered fund to focus on the characteristics of hedge funds and private equity funds, amending Super 23A provisions to bring them in line with Section 23A and Reg W, extending the seeding period for covered funds and narrowing the naming restriction and
    - Narrowing the scope of and permitting tailored compliance programs and eliminating metrics not necessary for effective supervision

For more information on the Volcker Rule's future, please visit the Fin Reg blog – "Visual Memorandum: Senate Bipartisan Banking Bill to Rebalance the Financial Regulatory Landscape" (March 28, 2018), "Treasury Asset Management and Insurance Report Makes Three Recommendations Tied to the Volcker Rule (Oct. 30, 2017), "Volcker Rule Commenters Largely Support Reforms" (Oct. 11, 2017), "OCC Seeks Input on Volcker Regulation Reforms" (Aug. 2, 2017), "Green Shoots for the Volcker Rule: a Thaw in the Guidance Freeze?" (July 25, 2017), "Federal Banking Agencies Recognize Unintended Consequences of Volcker Rule for Foreign Banks and Propose Temporary Solution" (July 21, 2017) and "Federal Reserve Releases Staff Paper on the Impact of the Volcker Rule" (Jan. 5, 2017)

Volcker Rule

- **Potential Methods of Change:**
  - The Treasury Asset Management Report recommends:
    - Refraining from enforcing the proprietary trading restrictions against foreign private funds that are not covered funds until a permanent solution to the identified challenges is implemented and enforcing the name-sharing restriction on funds sharing names with related banking entities and
    - Revising the definition of banking entity to include only IDIs, their holding companies, FBOs and affiliates and subsidiaries of such entities that are at least 25% owned or otherwise controlled by such entities
  - On March 5, 2018, Vice Chair Quarles stated that the five Volcker agencies are working on a proposal for public comment that would make material changes to the Volcker Rule. Examples of such changes include:
    - Clarifying the definitions of key terms, such as "proprietary trading" and "covered funds"
    - Clarifying the tests for RENTD to allow firms to utilize the market making-related activities exemption
    - Simplifying the requirements that foreign banks must meet to trade and engage in covered fund activities solely outside the United States
  - In the same March 5, 2018 speech, Vice Chair Quarles also noted that, although he supports a community bank exemption, such an exemption would require a statutory change
  - Vice Chair Quarles confirmed in his testimony before the House Financial Services Committee, however, that the banking regulators are working, in the coming proposal, to tailor the requirements of the Volcker Rule "particularly for firms that do not have large trading operations and don't engage in the sorts of activities that may give rise to proprietary trading"

Examinations

- **General Outlook:**
  - The Bipartisan Banking Bill would raise the total consolidated asset threshold, under which eligible well-capitalized and well-managed community banks may qualify for an 18-month examination cycle, from $1 billion to $3 billion
    - The Bipartisan Banking Bill passed the Senate, and House GOP leaders have agreed to hold a vote on the bill
    - A House bill, the Small Bank Exam Cycle Improvement Act of 2018, proposes to do the same
  - Proposed amendments in the CHOICE Act and other proposals indicate that reforms to banking regulators' examination processes designed to increase transparency and fairness may occur
  - Vice Chair Quarles recently stated transparency and efficiency are high on his agenda, adding "It can … mean simpler examination procedures for bank supervisors, or less intrusive examinations for well managed firms"
- **Potential Methods of Change:**
  - The Federal Reserve has proposed a new Large Financial Institution (**LFI**) rating system to replace the RFI rating system for BHCs with total consolidated assets of $50 billion or more and FBO IHCs
    - The proposed LFI rating system is designed to align with the current supervisory framework for large institutions
    - Includes component ratings for (1) capital planning and positions, (2) liquidity risk management and positions and (3) governance and controls
    - Each component rating must be satisfactory for LFI to be "well managed"

For more information on the Federal Reserve's proposed guidance for Boards, please visit the Fin Reg blog – "Comment Letter on the Proposed Guidance on Supervisory Expectation for Boards of Directors" (Feb. 15, 2018)

Examinations

- **Potential Methods of Change:**
  - The Federal Reserve has proposed to streamline and expedite the process for appealing material supervisory determinations (**MSDs**)
    - Would reduce the levels of appeal from 3 to 2, and require that each appeals level be overseen by independent review panels
    - Would establish an accelerated appeals process for MSDs that cause an institution to become critically undercapitalized (such as loan reclassifications)
  - Under the Federal Reserve's proposed guidance revising some of the supervisory expectations for Boards, most MRIAs and MRAs would be directed to senior management, not Boards
  - The Treasury Banking Report states that regulators should improve the coordination of their examination activities and rationalize their examination and data collection procedures to promote accountability and clarity

For more information on the Federal Reserve's proposed guidance for Boards, please visit the Fin Reg blog – "Comment Letter on the Proposed Guidance on Supervisory Expectation for Board of Directors" (Feb. 15, 2018)

Examinations

- **Potential Methods of Change:**
  - The Joint EGRPRA Report to Congress acknowledges the burden arising from examinations, and the member agencies of FFIEC state that they plan to continue their efforts to review their examination processes
  - The CHOICE Act would amend the FFIEC Act to:
    - require the timely production of final examination reports
    - establish an Office of Independent Examination Review within FFIEC, the director of which would, among other things, conduct reviews of examination quality assurance
    - provide for the de novo review of a material supervisory determination contained in a final exam report by the director of the Office of Independent Examination Review and for the judicial review of that decision and
    - prohibit regulators from retaliating against financial institutions for seeking review
  - The Financial Institution Examination Responsiveness Act would allow institutions to appeal final material supervisory determinations to a three-judge independent examination review panel

For more information on the Federal Reserve's proposed guidance for Boards, please visit the Fin Reg blog – "Comment Letter on the Proposed Guidance on Supervisory Expectation for Board of Directors" (Feb. 15, 2018)

Community Reinvestment Act

- **General Outlook:** Treasury Department, OCC and Federal Reserve leadership have been signaling since 2017 that change is coming to regulatory application of the Community Reinvestment Act (**CRA**)
  - In his April 2018 testimony to the House Financial Services Committee, Vice Chair Quarles said that the CRA has become "a little formulaic and ossified" and expressed a desire to move the CRA "off autopilot" and ensure that the law is being applied effectively and not "down the path of least resistance"
  - In April 2018, Treasury issued a memo to the federal banking regulators recommending reforms to the CRA framework that would "reduce complexity and burden on banks, regulators, and community advocates"
    - In the June 2017 Treasury Banking Report, Treasury had indicated the intention to "comprehensively assess how the CRA could be improved"
  - In October 2017, the OCC issued a revised CRA policy and framework, requiring a direct relationship between a discriminatory or illegal credit practice and the bank's CRA lending activities before the bank's CRA rating is affected, and consideration of a bank's remediation efforts
  - Comptroller Otting identified the need for CRA compliance reform in December 2017 and announced in February 2018 that he planned to solicit public comment on CRA improvements
    - Otting stated that CRA regulation "calls out for simplification … and clarity around what CRA is and how you would measure one's success"

For more information on the CRA, please visit the Fin Reg blog – "Treasury Offers Roadmap to CRA Reform" (Apr. 10, 2018) and "OCC Brings Common Sense to CRA Ratings" (Oct. 16, 2017)

Community Reinvestment Act

- **Potential Areas of Change:**
  - The Treasury Banking Report emphasized that CRA implementation "needs to reflect the variety of ways banks do business" and noted that "increasingly, banks use technology, such as automated and online offerings, to extend services outside of physical branches" and that "consideration should also be given to effective, innovative means of serving consumers and communities"
  - Treasury's April 2018 memo recommended four key areas for CRA reform:
    - Updating geographic assessment areas to better align with modern banking trends driven by changes in technology and consumer behavior;
    - Improving clarity and flexibility for CRA performance evaluations, particularly by having more transparent criteria;
    - Improving the timeliness of CRA performance evaluations; and
    - Re-evaluating penalties for nonperformance to better incentivize CRA performance
  - In an April 2018 speech, Comptroller Otting identified several CRA reforms under consideration by the OCC:
    - Placing greater weight on small business and student loans when assessing CRA compliance;
    - Tracking CRA compliance between examinations; and
    - Developing a single, quantitative metric to evaluate a bank's CRA activities regardless of the bank's size
  - The OCC may issue an advance notice of proposed rulemaking in the coming weeks
    - In testimony to the House Financial Services Committee, Vice Chair Quarles indicated that he expects the Federal Reserve and the FDIC will join the OCC's proposal
  - In an April 2018 speech, Federal Reserve Governor Lael Brainard indicated five outcomes that the Federal Reserve "will work toward in the interagency writing effort" to revise the CRA:
    - Modernization of assessment areas to account for banking activity beyond physical branches;
    - Encouraging banks to seek CRA lending opportunities in areas outside of the bank's major market;
    - Tailoring evaluation criteria for banks based on their size;
      - This concept is at odds with Comptroller Otting's vision to create a universal CRA measurement system for all banks, regardless of size
    - Greater consistency in examinations and ratings between and within each the agencies; and
    - Ensuring that revised regulations continue to combat discriminatory or unfair and deceptive lending practices

For more information on the CRA, please visit the Fin Reg blog – "Treasury Offers Roadmap to CRA Reform" (Apr. 10, 2018) and "OCC Brings Common Sense to CRA Ratings" (Oct. 16, 2017)

Enforcement Focus

Possible Change at the Agency Level

- **General Outlook:** Hard to predict, impact on companies may differ from impact on individuals, impact on ongoing enforcement may differ from new enforcement
  - Much will depend on the perspectives of Trump appointees
    - New agency heads and DOJ officials may alter existing policies for conducting investigations, initiating proceedings and negotiating settlements
    - Institutional momentum at the agencies is real
    - Co-Director of the SEC's Enforcement Division Steven Peikin has signaled that the SEC will pivot away from a prosecutorial approach but it is too early to measure whether enforcement trends reflect this approach
    - At the CFPB, Director Mulvaney has signaled a new approach focused on "more formal rule making and less regulation by enforcement"
  - Focus on individuals likely to continue
  - Impact may differ across subject areas, with efforts to change certain rules possible, but far from certain
    - President Trump has previously described the FCPA as a "horrible law" that "should be changed"
    - But, in his first public speech as Chairman of the SEC on July 12, Clayton stated that he does not foresee any changes to FCPA enforcement during his tenure
    - In addition, Attorney General Jeff Sessions has stated that enforcement of the FCPA "is critical" and that the Justice Department "will continue to strongly enforce the FCPA and other anti-corruption laws"
  - Should not lose sight of the state and foreign regulators and prosecutors who remain on the scene
    - Maria T. Vullo, Superintendent of the NYDFS, has indicated that the NYDFS will seek to fill any enforcement void left by deregulation at the federal level
      - NYDFS focus on FBOs for BSA/AML weaknesses likely to continue
      - First Part 504 transaction monitoring certifications due on April 15, 2018 – precursor to more enforcement?

Enforcement Focus

Possible Congressional Change

- **Potential Methods of Change:**
  - Congress may restrain certain aspects of federal financial regulatory agency enforcement
    - The CHOICE Act would impose additional limits on the federal financial regulatory agencies' enforcement authority
      - In general, federal financial regulatory agencies would be required to implement policies to:
        - Minimize duplication between federal and state authorities in bringing enforcement actions
        - Determine when joint investigations, administrative actions, judicial actions or the coordination of law enforcement activities are necessary, appropriate and in the public interest
        - Establish a lead agency for investigations and enforcement actions
      - CFPB and SEC litigants would have the right to remove administrative proceedings to federal court
      - CFPB
        - Would be limited to enforcement of enumerated consumer protection laws only (i.e., no supervisory or UDAAP enforcement authority)
        - Enforcement decisions would be subject to cost-benefit analysis requirement
        - Recipients of civil investigative demands could sue in district court to modify or set aside the demands

Enforcement Focus

Possible Congressional Change

- **Potential Methods of Change:**
  - Congress may restrain certain aspects of federal financial regulatory agency enforcement
    - The CHOICE Act would impose additional limits on the federal financial regulatory agencies' enforcement authority
      - SEC
        - Would be prohibited from seeking or imposing civil monetary penalties on issuers without first making findings as to whether the alleged violation resulted in direct economic benefit to the issuer and whether the penalty would harm the issuer's shareholders
        - Would not have the authority to bar individuals from serving as officers or directors of public companies
        - Would be required to establish a "Wells Committee 2.0" to reassess its enforcement program
        - Would be required to publish an updated enforcement manual and to publish annually an enforcement report that (1) details the SEC's enforcement and examination priorities; (2) reports on the SEC's enforcement and examination activities for the previous year; (3) analyzes litigated decisions found against the SEC in the previous year; (4) describes emerging trends the SEC has focused on in its enforcement program; (5) describes novel legal theories or standards employed by the SEC in enforcement; and (6) provides an opportunity and mechanism for notice and comment
        - Would be prohibited from awarding whistleblower awards to co-conspirators

AML / OFAC Sanctions

Economic Sanctions

- **General Outlook:** Significant uncertainty on the Trump Administration's approach to sanctions against Russia and North Korea, a rollback of the Iran nuclear deal – the Joint Comprehensive Plan of Action (**JCPOA**) and Iran sanctions is currently underway, though it is unclear if the Trump Administration will implement secondary sanctions against foreign countries that continue to do business in Iran
  - President Trump has criticized U.S. policy towards Iran and sanctions relief under the JCPOA. Congress has also expressed a willingness to strengthen Iran sanctions, as indicated by the inclusion of additional Iran-related sanctions in the recently-enacted Countering America's Adversaries through Sanctions Act (**CAATSA**)
    - On a number of occasions, the Trump Administration has taken the necessary steps to comply with U.S. obligations under the JCPOA, while simultaneously criticizing Iran and imposing additional sanctions – outside the scope of the JCPOA – against individuals and entities in connection with Iran's ballistic missile program, support for terrorism, or human rights abuses
  - On May 8, 2018, President Trump announced that he was terminating the United States' participation in the JCPOA with Iran and issued a National Security Presidential Memorandum directing his administration to immediately begin the process of fully re-imposing sanctions that target critical sectors of Iran's economy, including the energy, petrochemical, and financial sectors
    - Depending on the particular sanctions measure, the United States will provide either a 90-day or 180-day period in which activities permitted under or consistent with the JCPOA can be wound down
    - Following the conclusion of the applicable wind-down period, persons engaged in such activities involving Iran will face exposure to secondary sanctions or enforcement actions under U.S. law. After November 4, 2018, all U.S. sanctions (both primary and secondary) that had been waived or lifted under the JCPOA are expected to be re-imposed and in full effect

For more information on AML/OFAC sanctions, please visit the Fin Reg blog – "OFAC Targets Russian Oligarchs and Government Officials" (April 6, 2018), "Congress Shows Interest in Anti-Money Laundering Regulatory Reform" (Jan 10, 2018), "President Trump "Decertifies" the Iran Deal – What Happens Next?" (Oct. 16, 2017), "Additional Sanctions with Respect to North Korea" (Sept. 22, 2017), "House Passes Sanctions Legislation Against Iran, Russia, and North Korea; Veto Uncertain" (July 26, 2017), "Bipartisan Group of Senators Introduces Countering Iran's Destabilizing Activities Act of 2017" (Mar. 29, 2017), "Bipartisan Group of Senators Proposes Expansion of Sanctions on Russia" (Jan. 20, 2017) and "Publication of Updated Sudanese Sanctions Regulations" (Jan. 16, 2017). Please also see the Davis Polk Client Memorandums– "NYDFS Issues Final Rule on Transaction Monitoring and Filtering Programs for Regulated Institutions" (July 22, 2016) and "President Trump Withdraws from Iran Deal, U.S. Sanctions to "Snap Back" After Limited Wind-down Period " (May 9, 2018).

AML / OFAC Sanctions

Economic Sanctions

- **General Outlook:** Developments with respect to Russia, North Korea, and Cuba sanctions
  - CAATSA, which provides authority for additional sanctions against Iran, Russia, and North Korea, was signed into law on August 2, 2017
    - The Russia sanctions make up the bulk of the bill; the bill codifies existing sanctions on Russia and requires Congressional review of an attempt by the President to terminate, waive, or significantly modify current sanctions on Russia
    - On January 29, 2018, the Trump Administration faced its first major Russian Sanctions benchmark under CAATSA, and was to determine whether or not new sanctions were needed against those who conduct business with Russian defense and intelligence firms
      - The State Department announced that the administration was declining to impose any new sanctions, stating that "[CAATSA] and its implementation are deterring Russian defense sales"
    - Additionally, Treasury released a report titled "Report on Senior Foreign Political Figures and Oligarchs in the Russian Federation" to Congress on January 29, 2018, as mandated by CAATSA
      - Upon releasing the report, Treasury made explicit that it was not a sanctions list and those listed were not being subject to any sanctions, restrictions, prohibitions, or limitations
  - On April 6, 2018, OFAC sanctioned 7 Russian oligarchs and 12 companies they own or control, 17 senior Russian government officials, and a state-owned Russian weapons trading company and its subsidiary, a Russian bank under CAATSA
    - Because a number of the parties sanctioned have dealings with U.S. persons and other companies throughout the world, it is likely that OFAC's action will cause significant business disruptions and compliance challenges for both U.S. and non-U.S. persons
  - On June 16, 2017, President Trump announced Cuba sanctions policy changes, which will reinstate certain limits on educational travel and introduce new restrictions on transactions with entities controlled by the Cuban military and security services
    - On November 8, 2017, OFAC and the Commerce Department's Bureau of Industry and Security announced amendments to the Cuban Assets Control Regulations and the Export Administration Regulations to implement the changes announced by President Trump in June

AML / OFAC Sanctions

Economic Sanctions

- **Potential Methods of Change:**
  - An interagency review of U.S. policy toward Iran is ongoing. The Administration did not recertify Iran's compliance with the JCPOA in October and warned in January that it would not extend the necessary waivers to continue U.S. sanctions relief to Iran unless the JCPOA was renegotiated. As of now, the President's decisions do not immediately result in the reimposition of any Iran-related sanctions or place the United States in breach of its commitments under the JCPOA
  - On June 29, 2017, the Administration imposed sanctions and other measures on four Chinese individuals and entities, including a bank, for supporting North Korea's illicit activities. On September 21, 2017 the Administration issued a new E.O. expanding the Treasury's authorities to target those who enable the North Korean regime's economic activity
    - The full extent to which secondary sanctions are used to target China's economic support for North Korea remains to be seen
    - However, on November 21, 2017, the Administration designated one individual, 13 companies, and 20 vessels in an action targeted at disrupting North Korea's funding of its nuclear and ballistic missile programs; certain of these designations constituted the imposition of secondary sanctions on non-U.S., non-North Korean entities and individuals
  - CAATSA limits the Administration's ability to lift Russia sanctions, but leaves it with significant discretion in their implementation and enforcement

For more information on AML/OFAC sanctions, please visit the Fin Reg blog – "OFAC Targets Russian Oligarchs and Government Officials" (April 6, 2018), "Congress Hears Administration's View on Updating Anti-Money Laundering Framework" (Jan. 18, 2018), "Congress Shows Interest in Anti-Money Laundering Regulatory Reform" (Jan 10, 2018), "President Trump "Decertifies" the Iran Deal – What Happens Next?" (Oct. 16, 2017), "Additional Sanctions with Respect to North Korea" (Sept. 22, 2017), "House Passes Sanctions Legislation Against Iran, Russia, and North Korea; Veto Uncertain" (July 26, 2017), "Bipartisan Group of Senators Introduces Countering Iran's Destabilizing Activities Act of 2017" (Mar. 29, 2017), "Bipartisan Group of Senators Proposes Expansion of Sanctions on Russia" (Jan. 20, 2017) and "Publication of Updated Sudanese Sanctions Regulations" (Jan. 16, 2017). Please also see the Davis Polk Client Memorandum – "NYDFS Issues Final Rule on Transaction Monitoring and Filtering Programs for Regulated Institutions" (July 22, 2016)

AML / OFAC Sanctions

AML Generally

- **General Outlook:** Expect increased enforcement, with a focus on transparency and potentially on new financial technologies and platforms. Regulators will continue to focus on ultimate beneficial ownership of entities
  - In recent years, bank supervisory agencies, including the NYDFS, have brought substantial enforcement actions for AML violations, including violations of compliance standards
    - Political and regulatory climate suggests that these efforts will continue, and potentially accelerate
- **Potential Methods of Change:**
  - In February 2017, TCH published a report proposing a series of AML reforms, including having the Treasury's Office of Terrorism and Financial Intelligence take a more prominent role in coordinating AML policy across the government and having FinCEN reclaim sole supervisory responsibility for large financial institutions
    - In June, TCH President Greg Baer testified before the HFSC on the topic of AML reforms and outlined for Congress the recommendations made in the TCH report – the same day as the testimony, Congresswoman Maloney (D-NY), and Congressman King (R-NY) announced the introduction of bipartisan legislation to combat the use of anonymous shell companies to finance criminal activities, a legislative recommendation that has stemmed from the TCH report recommendation
    - Mr. Baer testified again before the Senate Committee on Banking, Housing, and Urban Affairs this January to discuss reform to the general federal AML framework along with former FBI Financial Crimes Program Chief Dennis Lormel and Heather Lowe, Legal Counsel and Director of Government Affairs of Global Financial Integrity
  - However, strong policy imperatives continue to underlie the general federal AML framework
    - Former Treasury Acting Under Secretary for Terrorism and Financial Intelligence Adam Szubin stressed the importance of Suspicious Activity Reports (including from smaller banks) for the global fight against terrorism, which is a declared priority of the Trump Administration

AML / OFAC Sanctions

Bank Secrecy Act

- **General Outlook:** Calls for amendments to the BSA, a 50-year old statute, are increasing
  - According to Dan Stipano, a former deputy chief counsel for the OCC, compliance with the BSA has become "extremely expensive and burdensome" and "large institutions spend upward of $1 billion annually on BSA compliance, and employ thousands of BSA compliance specialists to review alerts"
    - Smaller institutions, which "cannot afford sophisticated software or to hire an army of compliance specialists", are faced with strategic business choices that could affect their bottom line as a result
    - But "the consequences of getting [BSA compliance] wrong can be severe"
      - Currently, a large number of large and smaller financial institutions are subject to enforcement actions for BSA violations and "the size of civil money penalties for BSA violations has grown astronomically." Some financial institutions also are subject to deferred prosecution arrangements
- **Potential Methods of Change:**
  - Conduct a full review of the BSA regime that will reduce the cost and burdens of compliance with the BSA and more quickly provide better information to law enforcement, including through the use of artificial intelligence, Blockchain protocols and other newly created technologies
- **NY DFS Rule 504:** On June 30, 2016, NYDFS issued Rule 504 requiring regulated institutions to maintain "Transaction Monitoring and Filtering Programs" reasonably designed to (i) monitor transactions after their execution for compliance with BSA and AML laws and regulations, including suspicious activity reporting requirements; and (ii) prevent unlawful transactions with targets of sanctions
  - Rule 504 also required regulated institutions' boards of directors or senior officer(s) to make annual certifications to the DFS Superintendent confirming that they have taken all steps necessary to ascertain compliance with the Transaction Monitoring and Filtering Program requirements and that, to the best of their knowledge, the Program complies with the Final Rule. These requirements went into effect on January 1, 2017, and regulated institutions were required to file their first annual compliance certification by April 15, 2018

International Cooperation

- **General Outlook:** New conditions on U.S. involvement in international processes, but support for cross-border engagement on resolution planning
  - A Core Principle in President Trump's Feb. 3 executive order is the advancement of American interests in international financial negotiations and meetings
  - Former Chair Yellen affirmed the agencies' continued participation in the development of international regulatory standards; Chair Powell is expected to maintain this position
  - In January 2018, a group of Republican senators sent President Trump a public letter criticizing the FSB's level of influence on U.S. policy making, urging less deference to global standards and greater focus instead on the interests of U.S. entities and U.S. consumers
  - The Treasury OLA Report urges strong cooperation with non-US resolution authorities, not only to support preparedness but also to reduce foreign regulators' incentive to take harmful self-protective measures such as *ex post* ring-fencing or *ex ante* requirements to pre-position more capital and liquidity in host jurisdictions

- **Potential Methods of Change:**
  - The Treasury Banking Report recommends U.S. lead efforts to:
    - streamline the mandates of international standard-setting bodies' initiatives
    - eliminate existing overlapping objectives
    - increase transparency and accountability in these bodies
    - advocate for and shape international regulatory standards that are in alignment with domestic financial regulatory objectives
  - The CHOICE Act proposes:
    - to repeal Dodd-Frank provisions that expressly authorize the President, FSOC and the Federal Reserve to coordinate and consult with foreign regulators
    - to require the Federal Reserve, FDIC, OCC, Treasury, SEC and CFTC to consult with the House Financial Services Committee and Senate Banking Committee before participating in any process of international financial standards
    - that any negotiation and implementation of international standards would be subject to prior notice and comment
  - Section 211 of the Bipartisan Banking Bill seeks to promote greater transparency and accountability regarding U.S. regulators' participation in international insurance regulatory and supervisory bodies, e.g., by requiring annual reports to relevant Congressional committees from the Federal Reserve Chair and Treasury Secretary

Secure and Fair Enforcement Banking Act

- **General Outlook:** The direction of the federal regulatory and enforcement framework for financial institutions providing services to U.S. cannabis-related businesses is uncertain, and providing banking services to such businesses has therefore been considered too perilous by most large institutions. As additional states move toward legalized marijuana sales in 2018, the next measure of relief may be legislative
- **Potential Methods of Change:**
  - Legislative proposals in both the House and Senate have attracted bipartisan support:
    - The Secure and Fair Enforcement Banking Act of 2017 (**House SAFE Act**), introduced by Rep. Perlmutter in April 2017, now has 88 co-sponsors, including 12 Republicans
    - The Senate version of the Secure and Fair Enforcement Banking Act (**Senate SAFE Act**) introduced by Sen. Merkley in May 2017 (and re-introduced, though not successfully, as a proposed amendment to the Bipartisan Banking Bill in March 2018) now has 14 co-sponsors, including three Republicans
  - Although not identical, the House SAFE Act and Senate SAFE Act both prohibit federal banking regulators from:
    - Terminating a depository institution's deposit insurance solely because the institution provides financial services to a "cannabis-related legitimate business" operating pursuant to state law
    - Prohibiting a depository institution from providing financial services to such a business or to a state exercising jurisdiction over such businesses, or penalizing a depository institution for doing so
    - Recommending or incentivizing a depository institution not to offer financial services to certain account holders involved in such businesses
    - Taking certain adverse actions on loans to such businesses or to owners of real estate or equipment leased to such businesses
  - The bills provide protection from forfeiture of collateral for loans to such business or to owners of real estate or equipment leased to such businesses and from liability under Federal law for providing financial services to such businesses
  - The Senate Safe Act includes providers of financial services, including ETFs and retirement plans, related to cannabis, and providers of other business services relating to cannabis, in the definition of "cannabis-related legitimate business"

Executive Compensation

- **General Outlook:**
  - In a January 22, 2018 speech, SEC Chair Jay Clayton stated his belief in a "serial approach" to Dodd-Frank mandated executive compensation rules and highlighted recent SEC interpretive guidance on the pay ratio disclosure rule as representative of themes he is keeping in mind in addressing such rules: "true to the statutory mandate, practical, and intended to help companies reduce compliance costs"
  - Post-Dodd-Frank legislative efforts have included provisions that would repeal the statutory basis for provisions on financial institution incentive compensation, pay ratio and hedging, as well as limiting the scope of the clawback and say-on-pay provisions
  - Core Principles suggest that the proposed rules on financial institution incentive compensation are unlikely to be approved in their final form because of their wide scope
  - Companies are complying with the pay ratio disclosure rule in the 2018 proxy season
- **Changes on the Tax Front:**
  - The Tax Cuts and Jobs Act eliminated the "performance-based compensation" exception from the Section 162(m) limit on the deductibility of executive compensation and expanded the scope of covered employees to include a company's CFO and all employees who were covered in any year, so long as such employees receive compensation from the company (including after termination of employment)

For more information on the SEC pay ratio rule, please see the Davis Polk Client Memorandum – Pay Ratio Disclosure Rule: The SEC's Latest Guidance Should Ease Compliance Costs for Companies (Sept. 25, 2017) and the Davis Polk Client Memorandum – First Wave of Pay Ratio Disclosures Filed (Mar. 7, 2018). For more information on the Tax Cuts and Jobs Act's impact on Section 162(m) compensation, please see the Davis Polk Tax Reform and Transition Blog – Where the Final Tax Reform Bill Landed on Executive Compensation (Dec. 18, 2017) and the Davis Polk Client Memorandum – Administering Compensation Programs in the Wake of the Tax Cuts and Jobs Act – New Section 162(m) (Jan. 31, 2018)

DOL Fiduciary Rule

- **General Outlook:** Rule is now in partial effect; may be changed or repealed
  - The Trump administration's February 3, 2017, memorandum directs the DOL Secretary to examine the rule to determine whether the rule may adversely affect the ability of Americans to gain access to retirement information and financial advice and, as part of the examination, prepare an updated economic and legal analysis concerning the likely impact of the rule
    - The memorandum also directs the DOL to propose a new rule to rescind or revise the fiduciary rule if it concludes that the fiduciary rule is likely to do more harm than good or is inconsistent with the priories of the new administration
  - Despite calls for further delay, the rule went into partial effect on June 9, 2017
    - The fiduciary definition in the rule and the Impartial Conduct Standards in the exemptions became applicable on June 9, 2017
  - In August, the DOL filed a proposed amendment with the OMB that would further delay the remaining conditions and exemptions of the rule by 18 months, which would make the new full applicability date July 1, 2019
    - On November 24, 2017, the DOL officially delayed the applicability date of the remaining conditions and exemptions until July 1, 2019
  - However, although the DOL has stated that it will not enter into enforcement actions against firms under the rule, the Massachusetts Secretary of the Commonwealth filed an enforcement action against Scottrade on February 15, 2018, charging Scottrade with violating the rule by running two sales contests in June and September of 2017
    - The enforcement action calls on Scottrade to cease and desist such contests, for a disgorgement of any profits from the alleged wrongdoing, and imposes a fine

DOL Fiduciary Rule

- **Potential Methods of Change:**
  - The CHOICE Act would completely repeal the rule
    - The DOL would retain authority to issue a fiduciary rule but would be prohibited from doing so unless the SEC adopted a uniform fiduciary rule for investment advisers and broker-dealers, which the SEC would not be obligated to do
  - The Affordable Retirement Advice for Savers Act would completely repeal the fiduciary rule
  - The Protecting American Families' Retirement Advice Act in the House would provide for a 2 year delay in the implementation date of the rule
  - The DOL could amend or repeal the rule following a notice and comment period or delay the implementation date via a final rule or a final rule following a notice and comment period
  - The rule cannot be overridden by the Congressional Review Act procedure (51 votes in the Senate) because it was finalized outside the window for that process to be available
  - The SEC has unveiled a proposal called "Regulation Best Interest" which would require brokers (for all investment accounts) to provide retail customers with disclosures about their conflicts of interest and their responsibilities and ties to financial firms, as well as take affirmative steps to address any material conflicts of interest that may creative incentives that favor a broker's interest over that of a customer
  - On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit, in a 2-1 decision, vacated the rule in its entirety. The DOL has not contested the decision, and the order to vacate the rule was expected to take effect on May 7, 2018
  - On May 7, the DOL issued Field Assistance Bulletin 2018-02, providing firms with temporary enforcement relief under the rule. The Field Assistance Bulletin states that the DOL intends to issue additional guidance in light of the Fifth Circuit's actions, and pending the issuance of such guidance, the DOL will not pursue enforcement actions against firms "who are working diligently and in good faith to comply" with the rule

For more information on the impact and status of the DOL Fiduciary Rule, please visit the Fin Reg blog – "DOL Rule on Life Support" (March 30, 2018), "Delay of Full Applicability Date of Exemptions Related to Fiduciary Rule Now Official" (November 28, 2017), "RFI from DOL Signals More Uncertainty in the Future of Fiduciary Rule" (July 5, 2017), "DOL Fiduciary Rule: Officially Delayed for Now, with More to Come" (April 5, 2017), "What's Next for the DOL Fiduciary Rule?" (Feb. 4, 2017) and the Davis Polk Client Memorandum "The DOL Fiduciary Regulation and Its Impact on Financial Services Industry" (June 3, 2016)

Fintech Charters

- **General Outlook:** Bipartisan support for fintech charter but with different views on approach and an intense stakeholder scrum developing
- **Potential Methods of Change:**
  - Various bills, including the Financial Services Innovation Act of 2016, have been proposed over the last year to encourage fintech development and to provide for a fintech charter
  - The OCC proposed a framework for a special purpose national bank charter and released a draft licensing manual for the fintech charter, to a predictably mixed reception
    - Senators Brown and Merkley (of Volcker Rule fame) have raised questions about the fintech charter
    - House Republicans have shown resistance to the fintech charter, telling the OCC to hold off on finalization of fintech charter policy, given the impending change in leadership at the OCC
    - The NYDFS and Conference of State Bank Supervisors (**CSBS**) separately filed suit against the OCC, arguing that the agency lacked the legal authority to charter non-depository institutions. Both lawsuits were dismissed as speculative, given that the OCC has yet to consider or grant a charter to a fintech firm
      - In dismissing the CSBS complaint, the court signaled that the state regulators' claims would likely be ripe if the OCC actually were to grant a fintech charter
      - Comptroller Otting has said that the OCC will publish a formal position on the future of the charter sometime before the end of July
    - While serving as Acting Comptroller, Keith Noreika stated that the OCC has not yet decided whether it will actually issue fintech charters, but if it does decide to issue them, it could grant them to commercial firms
      - Comptroller Otting echoed this uncertainty, saying that the requirements to get a fintech charter need to be studied

For more information on FinTech charters, please visit the Fin Reg blog – "OCC Forges Ahead With Fintech Charter, Releasing Draft Licensing Manual Supplement" (Mar. 21, 2017) and "Beyond Fintech: The OCC's Special Purpose National Bank Charter" (Dec. 9, 2016)

Cybersecurity

- **General Outlook:** Cybersecurity can be expected to continue to be a high focus item for regulators; however, whether cybersecurity issues will be handled entirely on a regulatory basis or whether there will be legislative changes is unclear
  - All 50 U.S. states have data security laws in place
  - The first certification deadline for compliance with the NYDFS cybersecurity regulations in 23 NYCRR Part 500 passed on February 15, 2018. 23 NYCRR Part 500 became effective on March 1, 2018, and covered entities must comply with the next rounds of NYDFS requirements by September 3, 2018, and March 1, 2019
  - State and federal agencies have various data security regulations and procedures
  - Federal regulators have proposed data security laws, but these laws are not yet final
- **Potential Methods of Change:**
  - The Treasury Banking Report recommends that federal and state financial regulatory agencies coordinate regulation across sub-sectors
  - Congress could amend the Cybersecurity Information Sharing Act of 2015, though this may be unlikely, or create a new, more business friendly law altogether
  - Federal data breach and data security proposals have also been introduced in Congress by both parties over the last few years to impose federal breach notification requirements and substantive data security requirements on companies
  - The disclosure in September 2017 of an SEC EDGAR breach brought renewed focus on possible federal cybersecurity measures
  - The FSR supports harmonizing cybersecurity regulations

For more information on cybersecurity, please visit the Cyber Breach Center – "FTC Reaches Proposed Settlement With Mobile Phone Manufacturer BLU, Highlighting the Importance of Effective Oversight of Third-Party Vendor Data Security and Privacy Practices" (May 2, 2018), *"New Bipartisan Bill Shows Renewed Congressional Attention to Data Privacy and Security"* (April 25, 2018), *"Blockchain for Data Protection: A Double-edged Sword or a Techno-regulatory Oxymoron?"* (April 23, 2018), *"Had a Cyber Breach? The FBI Really Wants To Hear From You!"* (March 23, 2018), *"2018 SEC Cybersecurity Guidance on Board Oversight" (March 9, 2018), "Delegation, Not Abdication: The CFTC Fines AMP Global Clearing LLC for Failing to Supervise a Third-Party Service Provider" (Feb. 21, 2018), "Cryptojacking - A Real Cyber Threat, Even if You Don't Have to Tell Anyone" (Feb. 14, 2018),* and *"Cyber Breach Disclosure Now Comes With Limited Privilege Waiver Protection, If You're Careful" (Feb. 6, 2018)*

Cybersecurity

New Cyber Regulations in the Wake of Equifax

- **Equifax:** The theft of 145 million Americans' sensitive personal information has caused state and federal regulators to increase cyber enforcement
- **State:**
  - The Attorney General of Massachusetts sued Equifax for failing to secure data, late notification, unfair and deceptive business practices, under its data and consumer protection laws
  - Attorney Generals in New York, California, Illinois, and Pennsylvania have launched investigations into Equifax
  - Calls for NYDFS Cyber Rules to be expanded to cover credit reporting agencies
  - DFS cyber rules expanding in scope due to vendor requirements, becoming best practices. Regulators see advantages of certification and notification provisions
  - Several states looking to enact new cyber regulations
- **Federal:**
  - SEC, CFTC, FTC, OCC are all looking to expand cybersecurity enforcement
  - On April 24, 2018, the SEC announced the settlement of its first ever enforcement action against a company for an alleged failure to disclose a cybersecurity breach
  - On February 21, 2018, the SEC released updated interpretive guidance regarding disclosure of cybersecurity risks and incidents and noting the implications of cybersecurity incidents for insider trading compliance
  - Chair Powell during his confirmation hearing stated that cybersecurity "maybe the . . . single most important risk that our financial institutions, our economy" and "our government institutions face" and that the Federal Reserve is "very focused on providing the resources to deal with it and to make sure that the financial institutions we regulate and supervise address it"
- **International:**
  - Effective May 25, 2018, the EU General Data Protection Regulation can impose significant fines on organizations that fail to take reasonable measures to protect personal information

For more information on cybersecurity, please visit the Cyber Breach Center – "FTC Reaches Proposed Settlement With Mobile Phone Manufacturer BLU, Highlighting the Importance of Effective Oversight of Third-Party Vendor Data Security and Privacy Practices" (May 2, 2018), *"New Bipartisan Bill Shows Renewed Congressional Attention to Data Privacy and Security"* (April 25, 2018), *"Blockchain for Data Protection: A Double-edged Sword or a Techno-regulatory Oxymoron?"* (April 23, 2018), *"Had a Cyber Breach? The FBI Really Wants To Hear From You!"* (March 23, 2018), *"2018 SEC Cybersecurity Guidance on Board Oversight" (March 9, 2018), "Delegation, Not Abdication: The CFTC Fines AMP Global Clearing LLC for Failing to Supervise a Third-Party Service Provider" (Feb. 21, 2018), "Cryptojacking - A Real Cyber Threat, Even if You Don't Have to Tell Anyone" (Feb. 14, 2018),* and *"Cyber Breach Disclosure Now Comes With Limited Privilege Waiver Protection, If You're Careful" (Feb. 6, 2018)*

GSE Reform

- **General Outlook:** Serious attempts at GSE reform may be undertaken, but what will actually occur is unclear
  - Treasury Secretary Mnuchin has said that privatizing the GSEs is a "top 10" priority for the Trump Administration
    - He has clarified that he does not support "recap and release" and hopes to find a bipartisan solution
    - In January 2018, he stated that "the current situation of indefinite conservatorship for Fannie Mae and Freddie Mac is neither a sustainable nor a lasting solution" and noted the administration's preference for Congress to enact a long-term solution
  - But some Republican lawmakers want to eliminate the GSEs altogether
    - Better Way supports winding down the GSEs
- **Potential Methods of Change:**
  - Termination of GSE conservatorships as a step toward recap and release
    - Under the preferred stock purchase agreements (**PSPA**s), Treasury's consent is required to terminate the conservatorships
    - Treasury is no longer prohibited from selling its senior preferred stock in the GSEs without approval from Congress (the prohibition ended on January 1, 2018)
  - FHFA could convert conservatorships to receiverships, transfer all or some assets and liabilities to bridge institutions, and wind them down over 2-5 year period

GSE Reform

- **Potential Methods of Change:**
  - Treasury and FHFA could agree bilaterally to stop the net worth sweep or return payments in excess of terms in place before the controversial third amendment of those terms, allowing the GSEs to rebuild capital in preparation for re-privatization
  - Possible Legislative Action:
    - In January 2018, Sens. Corker and Warner circulated a draft proposal that broadly tracks a reform plan put forward by the FHFA, but an actual bill has not yet been released
    - In December 2017, Rep. Hensarling conceded that his prior PATH Act proposal would not succeed and explicitly endorsed a plan by a former top regulator of the GSEs
    - FRIA would prohibit the sale by Treasury of senior preferred stock in GSEs without approval from Congress, with no time limit on the ban, and facilitate the issuance of mortgage-backed securities by private issuers
- **Related Developments:**
  - The D.C. Circuit rejected key claims in one of the primary GSE shareholder cases (Perry Capital) regarding the net worth sweep; in February 2018, the U.S. Supreme Court declined to hear appeals from the shareholders
  - Under the PSPAs, the capital reserves of the GSEs were set to decrease to $0 on January 1, 2018. Facing a significant tax charge and net loss as a result of the 2017 tax legislation, the GSEs reached a deal with the Treasury to increase their permitted capital reserves to $3 billion each
    - Despite this increase, the GSEs had to request a draw on their line of credit from Treasury in February 2018 in order to cover their net losses for Q4 2017