Financial Services Regulatory Reform in 2017

A reference tool to be updated from time to time

Version as of November 1, 2017

These slides are designed to be a reference tool on 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.

Complex Mix of Legislative and Regulatory Changes

- 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
- The Treasury Department has published three reports on the conformity of U.S. financial regulations to the Core Principles set forth in President Trump's February 3rd Executive Order, which are designed to jump start financial regulatory reform
  - In June 2017, the Treasury Department published its first report (**Treasury Banking Report**), which focuses on banks and credit unions, including capital and liquidity, agency rulemaking, Volcker and the CFPB
  - In October 2017, the Treasury Department published its second report (**Treasury Capital Markets Report**), which focuses on capital markets, including debt, equity, commodities and derivatives markets, central clearing and other operational functions and its third report (**Treasury Asset Management Report**), which focuses on asset management and insurance
- Treasury will publish one other report containing recommendations on non-bank financial institutions, financial technology and financial innovation
- Treasury has also been instructed by the President to publish reports on FSOC and whether to repeal and replace the Orderly Liquidation Authority (**OLA**) with the Financial Institutions Bankruptcy Act (**FIBA**)

Complex Mix of Legislative and Regulatory Changes

- In addition to the Treasury Banking Report and Treasury Capital Markets Report, several other executive branch and legislative proposals form the backdrop for the overall regulatory reform policy discussion and are referred to throughout these slides
  - The Financial CHOICE Act of 2017 (**CHOICE Act**) was passed by the full House on June 8, 2017
    - Current wisdom suggests the chances of the bill being approved in its current form by the Senate are slim, but it reflects House Republican positions on a wide range of topics
  - 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
  - President Trump's Executive Order on Core Principles for Regulating the United States Financial System (**Core Principles**) was published in February 2017
  - 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

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Improving 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
    - See statement by Acting Comptroller Noreika and FDIC Chairman Gruenberg on examinations
  - Will also review interagency guidance, such as policy statements, to update and streamline guidance
- **Potential Methods of Change:**
  - The Treasury Banking Report recommends reassessing regulatory requirements on a bank'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 issued proposed guidance revising some of the supervisory expectations for Boards
    - Recommends an inter-agency review of the collective requirements imposed on Boards to tailor aggregate expectations and restore balance
  - 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
    - Calls for greater use of notices of proposed rulemakings and solicitation of public comments
  - 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

Federal Reserve Independence, Transparency and Structure

- **General Outlook:** Potential move to limit the Federal Reserve's monetary policy discretion and increase transparency
- **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
    - Make all 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
  - 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 Federal Open Market Committee (**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

Federal Reserve Independence, Transparency and Structure

- **Potential Methods of Change:**
  - 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
  - Senator Rand Paul's Audit the Fed bill would also subject the Federal Reserve's monetary policy decisions to audit by the Government Accountability Office
  - 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
  - Federal Reserve Vice Chair for Supervision Randal 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"

Efficient Executive Branch Structure

- **General Outlook:** Discussion of Executive Branch Structure in the Echo Chamber
  - President Trump issued an Executive Order in March 2017 directing the Director of the OMB to propose a plan to reorganize the executive branch, which is to include recommendations to merge agency functions
    - The plan could revive calls to reorganize or consolidate the federal banking agencies
  - Federal Reserve Vice Chair for Supervision Randal Quarles stated at his confirmation hearing that regulation could be improved by having a less “kaleidoscopic construction” of the regulatory system to make it easier for regulators to understand where risks really lie and where they don’t
  - Acting Comptroller of the Currency Noreika has said that two bank regulators (both the OCC and FDIC) are not needed to clear bank charters
  - **Echo Chamber Longshot:** Revive Bush 43’s Treasury Blueprint proposing regulatory agency consolidation and realignment
    - Consolidate financial agencies into a single financial stability regulator, a single prudential regulator and a single business conduct regulator
    - Limit the Federal Reserve to monetary policy and its role as the financial stability regulator

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 Service Committee's February 28 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
    - April 2017 Presidential Memorandum directed Treasury Secretary Mnuchin to conduct a thorough review of FSOC's SIFI determination/designation processes and to provide a report to the President, expected to be finished in October 2017
      - MetLife case suspended until review finished
      - AIG's SIFI designation was rescinded on September 29
        - Fed Chair Yellen supported the AIG de-designation, noting that the possibility of de-designation would provide "an incentive for designated firms to significantly reduce their systemic footprint"
  - In contrast, the Treasury Banking Report recommends larger FSOC role as regulatory coordinator
  - In October 2017, NEC Director Cohn publicly acknowledged bipartisan support for increasing the $50 billion asset threshold for SIFI designation to at least $200 billion

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FSOC Structure and Authority

Potential Methods of Change:

Greater Role in Coordination	Reduced or Modified Role in SIFI Designation

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 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

CFPB Structure and Authority

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

	Potential Methods of Change		
	Treasury Banking Report Recommendations	**CHOICE Act**	**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	
Funding	Subject funding to Congressional appropriations	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	
Supervision and Examination	Eliminate supervisory authority	Eliminate supervisory, examination and market-monitoring authorities Eliminate enforcement power over depository institutions	Raise examination threshold to $10B 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 commission*

CFPB Structure and Authority

- ***PHH v. CFPB*:**
  - D.C. Circuit panel held that the current CFPB structure (agency headed by a single director who can only be removed by the President for cause) is unconstitutional
  - This ruling was vacated by the *en banc* D.C. Circuit on February 16; oral argument before full court took place May 24; awaiting opinion
  - Department of Justice urged the court during oral argument on May 24 to strike down the provision restricting the removal of the CFPB director except for cause
- **State of Play:**
  - The President cannot remove Director Cordray except for cause, which we believe would be a heavy lift; others believe he could be removed now. The rumors that Director Cordray is planning to run for Ohio Governor in 2018 and will resign before his term ends (July 2018) are increasing in frequency
  - Equifax hack may increase support for CFPB and fuel resistance to calls to scale back its power

For more information on CFPB reform, please visit the Financial Regulatory Reform blog – "CFPB Reform: The Latest Developments" (Mar. 23, 2017), *"Leaked Hensarling Memo Outlines Proposed Changes to the CFPB"* (Feb. 10, 2017), *"Solicitor General, PHH File Briefs in PHH v. CFPB"* (Jan. 3, 2017) *and "CFPB Reform: The Battle in the Courts" (Nov. 21, 2016)*

Tailored Regulation by Size and Business Model

- **General Outlook:** Strong consensus around the notion that regulation should be tailored to a banking organization's business model and risk profile in addition to size but lack of clarity on how to get there
- **Some Change Has Already Occurred:**
  - In January, the Federal Reserve removed the qualitative portion of its 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; such relief should apply to most regional banking organizations
  - In March, the Federal Reserve raised the asset thresholds indicating presumptive financial stability concerns in banking M&A transactions
  - In September, the banking agencies proposed rules to simplify certain aspects of the capital rules, primarily for non-advanced approaches banking organizations
- Key Trump administration officials as well as Congressional leaders and others have supported the notion of tailoring regulation by size and business model
  - Federal Reserve Vice Chair for Supervision Randal Quarles stated in his confirmation hearing that he would support "tailoring capital regulation and other types of regulation to the particular character of the institutions that are regulated," including "their size" and "other aspects" of the institution
  - Treasury Secretary Mnuchin stated in July 2017 testimony that the $50 billion asset threshold for subjecting banks to EPS should be raised to at least $250 billion and that regulators should be able to exempt noncomplex banks at higher levels
    - In confirmation testimony, Treasury Secretary Mnuchin also supported reducing regulatory burdens for community banks and tailoring the regulation of regional banking organizations based on complexity and activity, not just size

For more information on the banking agencies' proposed rules to simplify certain capital rules please visit the Financial Regulatory Reform blog – "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 recent decision raising asset threshold in banking M&A transactions please visit the Financial Regulatory Reform blog – "A Modest Yet Welcome Thaw for Banking M&A and Financial Stability" (March 18, 2017). For more information on Treasury Secretary Mnuchin's suggestion that the EPS threshold should be raised to at least $250 billion please visit the Financial Regulatory Reform blog – "Higher Threshold for Enhanced Prudential Standard Comes into Focus" (July 27, 2017)

Tailored Regulation by Size and Business Model

- Key Trump administration officials as well as Congressional leaders and others have supported the notion of tailoring regulation by size and business model
  - Sen. Banking Chairman Mike Crapo has requested collaboration by Democrats and financial regulators in eliminating a "one-size fits all" threshold and Sen. Sherrod Brown has recently suggested he expects to reach a compromise with Sen. Crapo
  - In Senate testimony, Chair Yellen, Governor Powell, Acting Comptroller Noreika, and FDIC Chairman Gruenberg each stated support for simplifying the capital rules for community banks
  - In October 2017, NEC Director Cohn publicly acknowledged bipartisan support for increasing the $50 billion asset threshold to at least $200 billion
- A Core Principle is that financial regulations should be efficient, effective, and appropriately tailored
- **Potential Methods of Change:**
  - Legislative proposals would eliminate or raise the automatic $50B SIFI designation subjecting banks to EPS
    - SRDIA would eliminate the automatic $50B threshold for non-G-SIBs and replace it with a Federal Reserve designation process based on indicator-based measurements
      - Bipartisan Senate bill sponsored by Senators Perdue and McCaskill mirrors SRDIA and would remove $50 billion assert threshold and replace it with an indicator-based test
    - FRIA would raise the automatic $50B threshold to $500B and require an FSOC determination following prescribed procedures for institutions with $50B to $500B of assets
      - In contrast, Cornell law professor Saule Omarova argues that tailoring SIFI designations through a case-by-case, indicator-based system would undermine the entire post-crisis regulatory framework for safeguarding systemic stability by increasing uncertainty and leading to further deregulation

For more information on the banking agencies' proposed rules to simplify certain capital rules please visit the Financial Regulatory Reform blog – "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 recent decision raising asset threshold in banking M&A transactions please visit the Financial Regulatory Reform blog – "A Modest Yet Welcome Thaw for Banking M&A and Financial Stability" (March 18, 2017). For more information on Treasury Secretary Mnuchin's suggestion that the EPS threshold should be raised to at least $250 billion please visit the Financial Regulatory Reform blog – "Higher Threshold for Enhanced Prudential Standard Comes into Focus" (July 27, 2017)

Tailored Regulation by Size and Business Model

- **Potential Methods of Change:**
  - The Treasury Banking Report 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 in a wide range of areas:
    - **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
    - **Foreign Banking Organizations:** Increase thresholds for EPS and CCAR to match thresholds for U.S. entities, basing application on foreign banking organizations' U.S. risk profile rather than global assets

For more information on the banking agencies' proposed rules to simplify certain capital rules please visit the Financial Regulatory Reform blog – "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 recent decision raising asset threshold in banking M&A transactions please visit the Financial Regulatory Reform blog – "A Modest Yet Welcome Thaw for Banking M&A and Financial Stability" (March 18, 2017). For more information on Treasury Secretary Mnuchin's suggestion that the EPS threshold should be raised to at least $250 billion please visit the Financial Regulatory Reform blog – "Higher Threshold for Enhanced Prudential Standard Comes into Focus" (July 27, 2017)

Capital and Liquidity

General Outlook: Unfinished Business and Reassessment

- U.S. banking agencies have unfinished business in implementing or finalizing U.S. Basel III capital and liquidity requirements:
  - **Capital**

Finalized by Basel Committee	Under Consideration by Basel Committee
▪ 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	▪ Capital Floors for Credit Risk ▪ Already effectively implemented in United States via Collins Amendment

    - Implementation of Stress Capital Buffer (**SCB**) in capital requirements as announced by former Federal Reserve Governor Tarullo?
  - **Liquidity**
    - Net Stable Funding Ratio (**NSFR**) – proposed, not finalized
    - Liquidity Coverage Ratio (**LCR**) for FBO IHCs?

Capital and Liquidity

General Outlook: Unfinished Business and Reassessment

- The Treasury Banking Report 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 Supplemental Leverage Ratio (**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
- Tailoring capital, stress testing and liquidity requirements by factors such as size, risk profile and complexity has broad support, especially for community banks
  - In August, the Federal Reserve proposed to indefinitely stay the phase-in period for certain capital requirements for non-advanced approaches banking organizations
  - In September, the banking agencies proposed rules to simplify certain aspects of the capital rules, primarily for non-advanced approaches banking organizations

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

- **General Outlook:** 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 Treasury Banking Report recommends:
    - Increasing the threshold at which an FBO's U.S. IHC becomes subject to the CCAR process
    - 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
    - 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
  - Although some Treasury Banking Report recommendations could be effected by the Federal Reserve through revisions of its regulations (e.g., its CCAR and TLAC rules), others would require statutory changes to Section 165 of the Dodd-Frank Act
- **Elimination of IHC Requirement Remains Unlikely**: 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
  - In contrast, the Treasury Banking Report recommends that the Federal Reserve reconsider the level of internal TLAC requirements imposed on U.S. IHCs, which was set at the high end of the 75-90% range of external TLAC permitted by the Financial Stability Board's international TLAC standard

Orderly Liquidation Authority

- **General Outlook:** Risk of being replaced by Bankruptcy Code alternative, although a robust debate is ongoing
  - President Trump issued a Presidential Memorandum on April 21, 2017, that directed Treasury Secretary Mnuchin to conduct a review of OLA, including whether it is consistent with the Trump Administration's core principle against taxpayer-funded bailouts and whether a new chapter to the Bankruptcy Code would be a superior method of resolution for financial companies
  - Treasury Secretary Mnuchin has publicly supported a bankruptcy alternative to OLA and stated that "a lot of the need for [OLA]" would go away "if we have proper regulation"
  - He has also stated, however, that the Administration would listen to a variety of views when making determinations related to OLA
  - 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

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 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 to solvent entities
  - The FDIC could issue additional guidance or regulations to clarify certain aspects of OLA, even absent a statutory change
- The Treasury Secretary's report on OLA is expected in October 2017

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:**
  - The Treasury Banking Report recommends that the agencies change the living wills process by:
    - moving to a two-year cycle
      - Federal Reserve Governor Powell and FDIC Chairman Gruenberg have also expressed support for a two-year cycle
      - The Federal Reserve and FDIC extended the deadline for the U.S. G-SIBs' next 165(d) filing to July 1, 2019
    - raising the $50 billion threshold through an FSOC recommendation that would be adopted by the Federal Reserve and the FDIC
    - subjecting the living wills guidance and assessment framework to public notice and comment
    - requiring feedback on living wills within six months
  - 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 the CHOICE Act would not eliminate the IDI solo rule
  - 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

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 and the Commodity End-User Relief Act passed by the House (CFTC reauthorization bill)
  - 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
      - initiating a comprehensive review of the CFTC's swap data reporting regulations
      - establishing LabCFTC, an initiative aimed at promoting responsible fintech innovation
      - issuing a determination finding that the EU margin requirements for uncleared OTC derivatives are comparable to the CFTC's uncleared swap margin rules
      - seeking to delay for an additional year a decision on whether to modify the currently effective swap dealer *de minimis* registration threshold of $8 billion notional of dealing swaps
  - 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

For information on derivatives, please visit the Financial Regulatory Reform blog – "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:**
  - 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
  - The Treasury Capital Markets Report states that Treasury is not prepared to recommend a statutory amendment to exclude interaffiliate transactions from Title VII requirements entirely
  - The derivatives-related recommendations in the Treasury Capital Markets Report are likely to be implemented given that many of these recommendations hew closely to what the Trump-appointed heads of these commissions—Chris Giancarlo at the CFTC and Jay Clayton at the SEC—have said in recent public statements
    - The prospects are less clear for recommendations that require joint action with the U.S. banking regulators

For information on derivatives, please visit the Financial Regulatory Reform blog – "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, Federal Reserve Chair Yellen, Federal Reserve Governor Powell, Federal Reserve Vice Chair for Supervision Randal Quarles and 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"
  - Many industry groups responded to the OCC's August 2 request for information on potential changes to the Volcker Rule regulations, which respond to detailed questions regarding the scope of entities subject to the rule, the proprietary trading definition and the scope of proprietary trading exemptions, the covered fund definition and Super 23A provisions and the compliance program and metrics
  - Volcker Rule reform was one of the main agenda topics at the July 28 FSOC meeting
  - In the Joint EGRPRA Report, the OCC stated that it supports a community bank exemption
- **Potential Methods of Change:**
  - The CHOICE Act would completely repeal the Volcker Rule
  - 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

For more information on the Volcker Rule's future, please visit the Financial Regulatory Reform 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:**
  - 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
  - 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
    - refraining from enforcement of 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, defined as those in which there is 25% or more voting equity or voting power on the investment committee

For more information on the Volcker Rule's future, please visit the Financial Regulatory Reform 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

- **Ideas in the Echo Chamber:**
  - Revise the definition of proprietary trading to focus on short-term standalone proprietary trading
  - Reframe definition of covered fund on entities that rely upon section 3(c)(1) or 3(c)(7) that are principally engaged in speculative short-term trading
  - Simplify permitted activities and compliance
  - Move away from intent-based tests
  - Designate one agency as responsible for implementing, interpreting and enforcing the Volcker Rule
  - Exempt small banking organizations from the Volcker Rule

For more information on the Volcker Rule's future, please visit the Financial Regulatory Reform 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)*

Examinations

- **General Outlook:**
  - 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
  - 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
  - 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
    - Acting Comptroller Noreika and FDIC Chairman Gruenberg are jointly reviewing the examination process, examination report format, and examination report preparation process to identify further opportunities to minimize burden, principally by rethinking traditional processes

Examinations

- **Potential Methods of Change:**
  - 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
  - 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 Institutions Due Process Act of 2017 would allow institutions to appeal final material supervisory determinations to a three-judge independent examination review panel

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, but it remains to be seen who will be confirmed to key positions
  - 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

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

Enforcement Focus

SEC ALJs

- **Potential Methods of Change:**
  - Circuit courts are now split on whether the process for appointing SEC administrative law judges (**ALJs**) satisfies the Constitution's Appointments Clause and Supreme Court review is likely
    - 10th Circuit struck down the SEC's ALJ appointment process, holding on December 27, 2016 that SEC ALJs are "inferior Officers" who must be appointed by the President, "the Courts of Law" or the "Heads of Departments"
      - 10th Circuit denied the SEC's petition for a rehearing *en banc* on May 3, 2017
    - D.C. Circuit upheld the SEC's appointment process
      - This ruling survived an *en banc* rehearing that resulted in a 5-5 split vote on June 26, 2017
    - A petition for a writ of certiorari to review the D.C. Circuit case was filed with the Supreme Court on July, 21, 2017
      - A recent 5^{th} Circuit decision concerning the constitutionality of the appointment of FDIC ALJs is in line with the 10^{th} Circuit decision
      - This deepened the Circuit split and increases the odds that the Supreme Court will review the D.C. Circuit case

- **General Outlook:** Significant uncertainty on the Trump Administration's approach to the Iran nuclear deal – the Joint Comprehensive Plan of Action (**JCPOA**) and Iran sanctions as well as sanctions against Russia and North Korea
  - 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
  - At the same time, the JCPOA is a multilateral agreement that is popular with the other non-Iranian signatories of the JCPOA. Accordingly, it is unlikely that a return to the pre-JCPOA sanctions regime (which relied on support from Russia, China and Europe) is possible
    - On October 13, 2017, President Trump announced that he would not make the required quarterly certification to Congress because he was unable to certify that the provision of sanctions relief to Iran under the JCPOA is appropriate and proportionate to the specific and verifiable measures taken by Iran with respect to its nuclear program

For more information on AML/OFAC sanctions, please visit the Financial Regulatory Reform blog – "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)

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 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. Regulations implementing these changes have not yet been published
- **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. The President's decision does 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 extent to which secondary sanctions are used to target China's economic support for North Korea remains to be seen
    - 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 Financial Regulatory Reform blog – "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)*

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, 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
  - 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

International Cooperation

- **General Outlook:** New conditions on U.S. involvement in international processes
  - A Core Principle in President Trump's Feb. 3 executive order is the advancement of American interests in international financial negotiations and meetings
  - Federal Reserve Chair Yellen has affirmed the agencies' continued participation in the development of international regulatory standards
- **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
  - Systemic Risk Council urges legislators and regulators around the world to resist calls to dilute the fundamental pillars—including stronger capital requirements—of the international policy focus on stability since the financial crisis

Executive Compensation

- **General Outlook:**
  - The SEC will not be prioritizing the implementation of Dodd-Frank rules on financial institution incentive compensation
    - On June 20, 2017, the SEC released an agenda that did not prioritize restrictions on financial institution incentive compensation, e.g., longer time periods applicable to bonus deferrals and potential clawbacks
  - The pay ratio rule is likely to become effective without repeal or delay
    - On September 21, 2017, the SEC provided guidance on (i) the exclusion of independent contractors; (ii) the use of internal records to identify the median employee and to determine whether to include non-U.S. employees; and (iii) the flexibility in methodologies available to identify a median employee and calculate his or her compensation
- **Potential Methods of Change:**
  - The CHOICE Act would repeal the Dodd-Frank statutory basis for provisions on financial institution incentive compensation, pay ratio and hedging
    - The CHOICE Act would also amend statutory bases for clawbacks and say-on-pay to limit their scope
  - 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

For more information on the CHOICE Act's impact on Dodd-Frank executive compensation rules, please see the Davis Polk Client Memorandum – "Predictions on Possible Changes to and Timing of the Dodd-Frank Executive Compensation Provisions" (Dec. 12, 2016). 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).

DOL Fiduciary Rule

- **General Outlook:** Rule is now in partial effect; may be changed or repealed
  - The Trump administration's Feb. 3 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
  - After OMB review, on March 2, the DOL published a proposed rule that would delay the applicability date until June 9, 2017 and called for a comment period until April 17, 2017 regarding the rule overall
    - On April 4, the DOL published in the Federal Register a final rule that extends the applicability date of the rule for 60 days, including the applicability date for the two exemptions to the rule
  - 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. Compliance with the remaining conditions in the exemptions is not required until January 1, 2018
  - On June 29, 2017 the DOL put out a request for information seeking further input on the rule, a move that suggests the possible delay of the portions of the rule that come into effect on January 1, 2018
  - 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 January 1, 2019
    - The OMB has approved this proposal and the DOL is now seeking comments on the delay

For more information on the impact of the DOL Fiduciary Rule, please visit the Financial Regulatory Reform blog – "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)

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 signaled the willingness to draft a fiduciary rule that raises the fiduciary standard for brokers advising retail investors

For more information on the impact of the DOL Fiduciary Rule, please visit the Financial Regulatory Reform blog – "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 and Fintech Charters

- **General Outlook:** Bipartisan support for the fintech 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 have separately filed suit against the OCC, arguing that the agency lacks the legal authority to charter non-depository institutions
      - The OCC is defending the fintech charter in court, but Joseph Otting, Trump's nominee for OCC Comptroller, has not commented on the issue
      - The charter is stalled until stakeholder litigation is resolved
    - Acting Comptroller Noreika has 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
  - The CFTC announced new fintech initiative and innovation office, LabCFTC, to facilitate agency access and regulatory feedback for fintechs, as well as to promote the CFTC's own use of new technology

For more information on FinTech charters, please visit the Financial Regulatory Reform 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
  - Equifax hack likely to accelerate debate and proposals
  - NYDFS 180-day transitional period ended on August 28, 2017 for Covered Entities that are required to be in compliance with requirements of 23 NYCRR Part 500 unless otherwise specified
  - Federal regulators have proposed guidelines that are not yet final
  - Whether cybersecurity issues will be handled entirely on a regulatory basis or whether there might be legislative changes is unclear
- **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 recent disclosure of an SEC EDGAR breach has brought renewed focus on possible federal cybersecurity measures
  - The FSR supports harmonizing cybersecurity regulations

For more information on cybersecurity, please visit the cybersecurity blog – "After Equifax, to Whom Should the CISO Report? "(Oct. 16, 2017), "Your Sensitive Information Was Accessed in a Government Hack? You May Have No Remedy" (Oct. 6, 2017)

Cybersecurity
New Cyber Regulations in the Wake of Equifax

- **Equifax** – Theft of sensitive person information of 140M Americans has caused state and federal regulators to increase cyber enforcement.
- **State**
  - Mass. AG sued Equifax for failing to secure data, late notification, unfair and deceptive business practices, under its data and consumer protection laws
  - AGs in NY, CA, and Illinois have launched investigation 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, all looking to expand cybersecurity enforcement.
- **International**
  - EU GDPR effective May 2018, can impose significant fines for failure to take reasonable measures to protect personal information.

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
    - Although past statements referred to swift action on GSE reform, in September 2017 he said that it “is now a 2018 issue, with tax reform coming first”
  - 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, Treasury’s consent is required to terminate the conservatorships
    - 2015 legislation prohibits Treasury from selling its senior preferred stock in the GSEs until January 1, 2018 without approval from Congress
  - 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
  - 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

GSE Reform

- Possible Legislative Action:
  - The Johnson-Crapo bill to reform GSEs from 2014 could resurface
  - Rep. Hensarling could reintroduce his proposal to eliminate 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

Durbin Amendment

- **General Outlook:**
  - Opponents, including FSR, ABA and regional banks, argue that the Durbin Amendment has given a break to retailers at the expense of financial institutions, big box retailers have not passed down savings to consumers in the form of lower prices, and decreasing revenues for banks have reduced access to low-cost banking products
    - A 2017 paper by Federal Reserve researchers found that affected banks: were 35.2% less likely to offer "free checking" accounts than they were before the amendment; raised monthly fees on noninterest accounts by 20% and interest checking accounts by 17%; and made it more difficult for accountholders to avoid paying monthly fees
  - Proponents maintain that profits in retail have not soared, especially when compared to the profit margins of banks, and that the Durbin Amendment benefits consumers by preventing price-fixing and anti-competitive behavior
  - Durbin Amendment is notably absent from the Treasury Banking Report
- **Potential Methods of Change:**
  - Although the version of the CHOICE Act that passed the HFSC would have completely repealed the Durbin Amendment, the amended version of the CHOICE Act that passed in the House omitted the Durbin Amendment's repeal