Financial Services Regulatory Reform

Post Midterm Election Edition

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

Table of Contents

Improving Supervision and Regulation		
The Changed Regulatory Engagement Model Slides 3–4	**Structure and Authority: The Bureau** Slides 5–7	**Structure and Authority: FSOC** Slides 8–9
Guidance Slides 10–11	**“Control” and “Controlling Influence”** Slide 12	**Rating Systems and Governance** Slides 13–14
Examinations Slides 15–16	**Attorney-Client Privilege** Slide 17	**International Cooperation** Slides 18–19
Prudential Directives and the Regulatory Landscape		
Tailored Regulation Slides 20–23	**Capital and Stress Testing** Slides 24-32	**Liquidity** Slide 33
TLAC Slide 34	**Foreign Banking Organizations** Slides 35–37	**Orderly Liquidation Authority** Slides 38–39
Living Wills Slides 40–41	**Volcker Rule** Slides 42–43	**Community Reinvestment Act** Slides 44–46
Anti-Money Laundering and Bank Secrecy Act Slides 47–48	**OFAC Sanctions** Slides 49–51	**Derivatives** Slides 52–55
Executive Compensation Slide 56	**Regulation Best Interest** Slides 57–58	
Emerging Frameworks		
Cannabis-Related Banking Slides 59–60	**Fintech Charters** Slide 61	**Cybersecurity** Slides 62–63
Appendix A: Executive Order and Treasury Reports Slide 64		

Momentum for Change Will Largely Come from the Agencies

Financial regulatory reform, driven by new statutory mandates and changes in agency leadership and personnel, will continue to occur through a mix of regulations, interpretations and guidance, with the courts engaged by stakeholders on all sides.

Post-Midterms State of Play	
EGRRCPA	• The Economic Growth, Regulatory Relief, and Consumer Protection Act (**EGRRCPA**), with significant support from both sides of the aisle, was signed by President Trump on May 24, 2018. • EGRRCPA impacts a number of areas of financial regulation and its implementation has been high on the agencies' agendas. The Federal Reserve proposed rules including a number of implementing provisions on October 31, and agency leaders emphasized at an October 2 Senate Banking Committee Hearing that these efforts will continue in 2019.
Other Legislation	• With a divided Congress following the midterm elections, the prospects for statutory reform in the next two years are uncertain, and will be seen only in those limited areas with bipartisan support or as a result of extensive negotiation and compromise. • Although the House passed the JOBS and Investor Confidence Act of 2018 (**JOBS 3.0**) by a vote of 406-4 in July, and Rep. Hensarling stated that Senate Majority Leader McConnell had committed to a Senate vote, its prospects are dimming as the current session of Congress draws to a close and Rep. Hensarling retires. JOBS 3.0 focuses largely on capital markets reform provisions, but also includes other financial regulatory reform topics.
Regulators Forge Ahead	• Even absent additional legislation, the federal agencies have a full roster of regulatory reform priorities and new initiatives to complement statutory implementation mandates. • A number of reform priorities have been informed by a series of six Treasury Department reports (**Treasury Reports**) on the conformity of U.S. financial regulations to a set of core principles (**Core Principles**) enumerated by President Trump in a February 2017 Executive Order. Links to that Executive Order and the Treasury Reports are provided in **Appendix A**.

The Changed Regulatory Engagement Model

- **General Outlook:** The Trump agency leadership has changed how regulators engage with the banking sector. The leadership is supporting enhanced transparency, focusing on accountability, and drawing on lessons learned during the last ten years to revise supervisory approaches as well as addressing new challenges posed by changing technologies and business models—many of its recommendations are shaped by core principles set by the Trump administration. Key themes and areas of focus for current agency leadership include:

Transparency

- Federal Reserve Chairman Powell has stated that the Federal Reserve will continue to "strive to find better ways to enhance transparency" and "strengthen the foundation of democratic legitimacy."
- The Federal Reserve's first Supervision and Regulation Report, released on November 9, was a paradigm shift in transparency, containing aggregate ratings and supervisory actions of banking organizations by type—large, foreign, community and regional.
  - That report was released in anticipation of Vice Chairman for Supervision Quarles' testimony before Congress the following week, during which he reiterated that "transparency is part of the foundation of public accountability" and "a cornerstone of due process."
  - Quarles went on to explain how the Federal Reserve's commitment to transparency has underpinned a number of the actions it has taken in 2018 and will continue to inform future actions, including increased visibility in the supervisory stress testing program.
- In October 2018, FDIC Chairman McWilliams announced a "Trust through Transparency" initiative aimed at making the FDIC "accessible, understandable, responsive, and accountable," which includes a reevaluation of the "proper balance between protecting confidential information and providing public access."

Simplicity and Clarity

- Regulatory leadership is also focusing on reducing the complexity of banking sector regulation.
- Chairman McWilliams has commented that the regulators' job is to "make sure the regulations we promulgate give [regulated entities] a clear path."

For more information on the regulatory engagement model, please visit the FinReg blog – "A Breath of Fresh Air at the FDIC: The "Trust Through Transparency" Initiative" (Oct. 5, 2018) and "As Regulatory Reform Push Continues, Federal Reserve Vice Chair for Supervision Randal Quarles Sets Out His Guiding Principles" (Jan. 23, 2018).

The Changed Regulatory Engagement Model

- Similarly, Comptroller Otting emphasized in testimony before the Senate Banking Committee the need to rationalize the regulatory framework, including through reducing unnecessary regulatory burden and simplifying regulatory capital requirements.
- As described in August 2017 proposed guidance, the Federal Reserve has been conducting a comprehensive review of certain regulations, interagency guidance and supervisory letters to reduce redundancy and clarify agency expectations.

Efficiency

- Agency leadership is concentrated on striking an efficient balance between compliance burden and the attainment of regulatory and financial stability objectives, consistent with the Core Principles and the recommendations for enhanced use of regulatory cost-benefit analysis in the Treasury Report issued in June 2017, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (**Treasury Banking Report**).
- Chairman McWilliams has commented that she wants to "see the exact nexus" between post-financial crisis rulemaking and how those rules will prevent future harm to the financial system.
- Likewise, Vice Chairman for Supervision Quarles observed in testimony before the House Financial Services Committee that "regulation of [the financial] system should support and promote the system's efficiency just as it promotes its safety."
  - Quarles framed the issue before the Senate Banking Committee, stating that "supervision is not costless, either to the public or to supervised institutions," and concluding that "activities and firms that pose the greatest risk should receive the most scrutiny, and where risk is lower, the regulatory burden should be lower as well."

Emerging technologies & paradigms

- Encouraging innovation in the banking sector and the emergence of fintech is receiving increased attention across all of the agencies.
- The OCC has started accepting applications for special-purpose national bank charters, discussed further below in the Fintech Charters section.
- The Office of Innovation established in July 2018 by the Bureau of Consumer Financial Protection (**Bureau**) has proposed the creation of a "Disclosure Sandbox" to allow companies to trial new ways of communicating with and making disclosures to consumers.
- Further, in October 2018, Chairman McWilliams announced the creation of a new FDIC innovation office.

Structure and Authority: The Bureau

- **General Outlook:** There are calls by the Trump Administration, Acting Director Mulvaney, and the private sector for a recalibration of the power of the Bureau, formerly named the Consumer Financial Protection Bureau (**CFPB**), through both reorganization and circumscribed authority, with Democratic senators and the Democratically controlled House having a very different view.
- **Defense of the Bureau:**
  - Democrat Rep. Waters of California appears poised to take the chair of the House Financial Services Committee following the midterm elections.
  - In a November 9 letter making her case to become Chairwoman of that committee, Rep. Waters reiterated her vigorous support for the Bureau, vowing to put "consumers first by engaging in robust oversight of Mulvaney's actions at the [Bureau] and righting the many wrongs he has committed."
  - Rep. Waters has expressed her view that "Mulvaney's very presence at the [Bureau] and his role at OMB compromises the critical independence of the agency."
- **Bureau 2018 Semi-Annual Report:**
  - The first semi-annual report issued under Acting Director Mulvaney includes a request that Congress make four changes to the law in order to establish meaningful Bureau accountability:
    - Fund the Bureau through Congressional appropriations
    - Require legislative approval of major Bureau rules, a change we view as unlikely to happen
    - Ensure that the Director answers to the President in the exercise of executive authority
    - Create an independent Bureau Inspector General
  - Acting Director Mulvaney reiterated these four requests in his April 2018 testimony before Congress.

Structure and Authority: The Bureau

- **Judicial Developments:**
  - Appeals challenging the constitutionality of the Bureau's structure are pending in multiple circuits, including the Fifth Circuit. We believe a circuit split on the constitutionality of the Bureau's structure, followed by Supreme Court review, is increasingly likely.
  - On June 21, Senior United States District Judge Preska, presiding over *CFPB v. RD Legal Funding, LLC* in the Southern District of New York, found the Bureau's structure unconstitutional, in disagreement with the *en banc* ruling of the D.C. Circuit in a different case, *PHH v. CFPB*. On September 14, the Bureau filed a notice of appeal to the Second Circuit.
  - The majority opinion of the D.C. Circuit, sitting *en banc*, in *PHH* had upheld the constitutionality of the Bureau's structure. Instead, Judge Preska adopted much of the dissent of Judge Kavanaugh, then a D.C. Circuit judge and now a Supreme Court Justice, in *PHH* to find that the structure of the Bureau—an agency headed by a single director, removable by the President only for "inefficiency, neglect of duty or malfeasance in office"—is unconstitutional.
  - In contrast to Judge Kavanaugh's dissent, however, Judge Preska found that the specific unconstitutional provision is not severable from the remainder of Title X of the Dodd-Frank Act, and therefore determined that the entirety of Title X must be struck down. In his September confirmation hearings before the Senate Judiciary Committee, Judge Kavanaugh reiterated the remedy from his dissent: "I said the agency can keep operating … I specifically and explicitly rejected [throwing the Agency out] as a remedy."
  - We also note the recent Fifth Circuit *per curiam* decision in *Collins v. Mnuchin*, which included a claim that the Federal Housing Finance Agency (**FHFA**) is "unconstitutionally structured because… it is headed by a single Director removable only for cause." In finding that the FHFA is unconstitutionally structured, the Fifth Circuit stated that agencies "may be independent, but they may not be isolated," and that courts "must look at the aggregate effect of the insulating mechanisms." The *Collins* court distinguished its ruling from *PHH*, but repeatedly cited the dissents of Judges Kavanaugh and Henderson in *PHH*.
  - On November 12, the Fifth Circuit ordered that *Collins* be reheard by the court *en banc.* One of the pending challenges to the Bureau's structure is awaiting oral argument in the Fifth Circuit.

For more information on the Bureau litigation, please visit the FinReg blog – "SDNY Weighs In on the Constitutionality of the CFPB's Structure" (June 22, 2018). For more information on the FHFA litigation, please visit the FinReg blog – "Fifth Circuit Holds That FHFA is Unconstitutionally Structured" (July 18, 2018).

Structure and Authority: The Bureau

- **Bureau Leadership:** Richard Cordray resigned as Bureau Director on November 24, 2017 and President Trump appointed OMB Director Mulvaney as Bureau Acting Director under the authority granted to him by the Federal Vacancies Reform Act of 1998 **(FVRA**).
  - On June 18, 2018, President Trump nominated Kathleen Kraninger, currently Program Associate Director for General Government in the Office of Management and Budget, to be the permanent Director of the Bureau.
  - On August 23, the Senate Banking Committee approved Kraninger in a 13-12 party-line vote. The full Senate is expected to vote on her confirmation the week of November 26.
  - In her July 19 testimony before the Senate Banking Committee, Kraninger laid out her four priorities for the Bureau should she become Director:
    - To be fair and transparent, ensuring that Bureau actions empower consumers to make good choices and provide certainty for market participants, and particularly including the use of cost benefit analysis
    - To work closely with other financial regulators and states on supervision and enforcement to take aggressive action against bad actors
    - To ensure that data is protected and limit data collection to what is needed and required by law
    - To be accountable to the American people, including for the expenditure of resources
  - Acting Director Mulvaney could remain at the Bureau through 2018 and into 2019.
    - Under the FVRA, once the President nominates a permanent appointee, the acting appointee may continue to serve while the permanent appointee's nomination is pending. If the permanent appointee's 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.

Structure and Authority: FSOC

- **General Outlook:** The Treasury Department's vision regarding appropriate FSOC authority should govern for the near future. Republicans in Congress had previously called for significant FSOC organizational changes, but the possibility for these changes is remote given Republicans' loss of control of the House.
  - The Treasury Report issued in November 2017, *Financial Stability Oversight Council Designations* (**Treasury FSOC Report**), and 2017 Annual Report, make it clear that the Treasury Department envisions both maintaining the current designation role for FSOC and expanding its coordination role.
  - In Treasury's view:
    - The 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.
    - The FSOC should prioritize activities-based, product-based or industry-wide risk identification, rather than singling out individual firms.
    - 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.
    - The FSOC should focus on activities-based regulation.
- **Designation Power**
  - With the FSOC's October 2018 rescission of Prudential's designation as a non-bank systemically important financial institution, there are no longer any non-bank financial companies subject to supervision by the Federal Reserve.

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

Structure and Authority: FSOC

- **Potential Changes Under Current Authority:**
  - The FSOC may make more aggressive use of its current 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.
  - A Treasury official stated in September 2018 that the FSOC would be moving toward "an activities-based approach to designations" rather than a firm-focused approach.
- **Potential Changes Requiring Congressional Action:**
  - 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 and reforming the FSOC to further facilitate information sharing and coordination among regulators.

Guidance

- **General Outlook:** In response to repeated questions from Congress and after a period of considerable uncertainty for financial institutions, the Federal Reserve, FDIC, OCC, NCUA and the Bureau released an interagency statement meant to clarify the role of supervisory guidance (**Interagency Guidance Statement**). Shortly thereafter, SEC Chairman Clayton released a statement of his own (**Clayton Statement**).
- **Interagency Guidance Statement:**
  - The Interagency Guidance Statement affirms that, unlike a law or regulation, "supervisory guidance does not have the force and effect of law." As a result, "the agencies do not take enforcement actions based on supervisory guidance."
  - The Interagency Statement makes five commitments:

Interagency Guidance Statement Clarifying the Role of Supervisory Guidance – Key Commitments
• The agencies will limit the use of numerical thresholds or other "bright-lines" in describing expectations in supervisory guidance. Where numerical thresholds are used, those thresholds are exemplary only and not suggestive of requirements.
• Examiners will not criticize a supervised financial institution for a "violation" of supervisory guidance (the agencies put quotation marks around the word violation). Rather, any citations will be for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions.
• Soliciting public comments on supervisory guidance is helpful to the agencies, and the agencies may continue to seek such comments, but soliciting comments does not mean that supervisory guidance is intended to have the force and effect of law.
• The agencies will seek to reduce the issuance of multiple supervisory guidance documents on the same topic.
• The agencies will continue efforts to make the role of supervisory guidance clear in their communications to examiners and to supervised financial institutions

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

Guidance

- **Clayton Statement:**
  - The Clayton Statement reiterates the SEC's "longstanding position" that all staff statements are nonbinding and "create no enforceable legal rights or obligations . . . it is the Commission and only the Commission that adopts rules and regulations that have the force and effect of law."
  - Directors of the Division of Enforcement and the Office of Compliance Inspections and Examinations have been instructed to "further emphasize" to their staffs the distinction between rules and regulations and staff views.
  - More generally, the SEC's divisions and offices have been and will continue to review whether prior staff statements and documents should modified, rescinded or supplemented "in light of market or other developments."
- **Request for Further Rulemaking and Additional Developments of Interest:**
  - In early November, the American Bankers Association and the Bank Policy Institute (**BPI**) petitioned the Federal Reserve to engage in rulemaking to codify the Interagency Guidance Statement and to include in such rulemaking a clear statement that matters requiring attention (**MRAs**) and matters requiring immediate attention (**MRIAs**), examination rating downgrades, memoranda of understanding, and any other formal examination mandate or sanction will be based only on a violation of a statute, regulation or order.
  - In sharp contrast, Senator Warren pressed Vice Chairman for Supervision Quarles during his November 15 appearance before the Senate Banking Committee to enforce as binding the leveraged lending guidance issued by the federal banking regulators in 2013.
    - Senator Warren noted approvingly the instances in the past where the Federal Reserve had "directed" firms to "abide by the guidelines"—an apparent reference to public reports that the leveraged lending guidance had served as the basis for MRAs and MRIAs.
    - Vice Chairman for Supervision Quarles reiterated that the Federal Reserve would monitor compliance with safety and soundness but noted that "to enforce guidance is inappropriate."
  - Relatedly, it is notable that the Federal Reserve's Supervision and Regulation Report refers to MRAs and MRIAs as "recommendations."

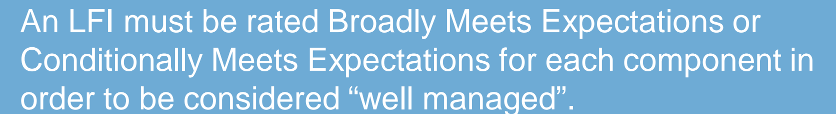
"Control" and "Controlling Influence"

- **General Outlook:** The Federal Reserve plans to make "metamorphic" changes to how it determines whether one company has a "controlling influence" over the management or policies of another company for purposes of the Bank Holding Company Act (**BHC Act**). A proposal to codify the Federal Reserve's control framework is expected soon.
- **Room for Improvement:**
  - In keeping with the broader regulatory agenda of the Federal Reserve under the current administration, we expect the proposed changes will make the process for control determinations more transparent, simpler to understand, easier to apply and more consistent with the rule of law.
  - The current definition of "control" under the BHC Act, and particularly the Federal Reserve's interpretations of "controlling influence", have created too much uncertainty in connection with investments in and by the banking sector.
  - This uncertainty has led bank holding companies to limit their investments in fintech firms and restrain their business relationships with those firms for fear of being deemed to have "control" or a "controlling influence" over them.
  - The current control framework also conflicts with the Federal Reserve's efforts to be more transparent. Many control precedents are not public and many have been communicated only in discussions with Federal Reserve staff.
    - Noting that the Federal Reserve's definition of control in practice has been "quite a bit more ornate" than what is set out in the BHC Act, Vice Chairman for Supervision Quarles has joked that the only way one can become familiar with these interpretations is through an "apprenticeship in the art of Fed interpretation" with knowledge passed down through the generations as it is from a "shaman to a novice."

For more information on this topic, please visit the FinReg blog – "Treasury Calls on the Federal Reserve to Reassess the BHC Act Control Framework to Facilitate Innovation" (Aug. 6, 2018) and "Federal Reserve Signals Long-Overdue Re-examination of BHC Act Control Framework" (Jan. 24, 2018).

Rating Systems and Governance

- **General Outlook:** The Federal Reserve has finalized a new rating system for large financial institutions (**LFI Rating System**) that is meant to more closely align supervisory ratings for LFIs with the substantial changes made to the statutory and regulatory framework governing LFIs since the existing RFI/C(D) rating system—currently applicable to all BHCs regardless of size or complexity—was adopted in 2004.
- **LFI Rating System:** In November 2018, the Federal Reserve adopted its new LFI Rating System, generally with only minor changes from its August 2017 proposal. Our visual memorandum discussing the LFI Rating System in detail is available here.
  - The LFI Rating System includes component ratings for (1) capital planning and positions, (2) liquidity risk management and positions and (3) governance and controls, which will evaluate the effectiveness of an LFI's (a) board of directors, (b) management of business lines and independent risk management (**IRM**) and controls and (c) recovery planning, for LISCC firms only.
  - The LFI Rating System establishes a four-category rating scale:
    - Broadly Meets Expectations
    - Conditionally Meets Expectations
    - Deficient-1
    - Deficient-2



  - LISCC firms, including the U.S. intermediate holding companies (**IHCs**) of foreign banking organizations (**FBOs**) that are LISCC firms, will receive their first ratings under the LFI Rating System in early 2019, and domestic holding companies with $100 billion or more in total consolidated assets and U.S. IHCs of FBOs with $50 billion or more in total consolidated assets that are not LISCC firms will receive their first ratings in early 2020.

Rating Systems and Governance

- **Related Proposed Guidance:** The Federal Reserve has also issued a series of related proposals that would recalibrate supervisory expectations for boards of directors, senior management, the management of business lines and IRM. Our visual memorandum discussing these proposals in detail is available here.
  - When finalized, these recalibrated supervisory expectations will be used to evaluate an LFI's performance under the governance and controls component of the LFI Rating System. Until then, an LFI will be evaluated for purposes of the governance and controls component based on existing supervisory guidance.
- **Further Developments:** The preamble to the final rule implementing the LFI Rating System states that the Federal Reserve is considering further changes to the ratings systems applicable to banking organizations. These changes may include:
  - Adjustments to the asset threshold for applicability of the LFI Rating System to U.S. IHCs (currently $50 billion).
  - Adjustments to the ROCA rating system, which assigns ratings to the U.S. branches and agencies of FBOs.
  - Revisions to the RFI/C(D) rating system as applied to BHCs with total consolidated assets of at least $50 billion but less than $100 billion.
- **CAMELS Ratings:** Separately, FDIC Chairman McWilliams plans to seek comment on ways to improve the CAMELS ratings system used to assign ratings to insured depository institutions, which was first adopted in 1979 and last updated in 1996.

Examinations

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

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

Examinations

- **In February 2018, the Federal Reserve proposed to streamline and expedite the process for appealing material supervisory determinations (MSDs) by:**
  - Reducing the levels of appeal from three to two and requiring that each appeals level be overseen by independent review panels
  - Establishing an accelerated appeals process for MSDs, such as loan reclassifications, that cause an institution to become critically undercapitalized
  - Including extensive provisions to protect banking organizations against retaliation by Federal Reserve staff for exercising the right to appeal, although uncertainty remains whether such provisions can ever by truly effective
- **The Supervision and Regulation Report issued on November 9 confirmed the Federal Reserve's continuing commitment to paradigmatic reform of transparency in examination and supervision.**
  - The Federal Reserve reiterated its commitment to reforming the examination appeals process.
  - The data included aggregate ratings and supervisory actions for banking organizations by type—large, foreign, community and regional—and revealed that the number of outstanding MRAs and MRIAs have generally decreased, except with respect to large FBOs, which have seen MRAs and MRIAs increase due to regulatory changes that require changes to their U.S. structures.
  - Firms have improved in areas such as capital planning and liquidity management but continue to need improvement in risk management areas such as compliance, internal controls, model risk management, operational risk management and IT infrastructure.
  - Some firms continue to exhibit weaknesses in BSA/AML programs, which sometimes have longer remediation timelines.

For more information on the Federal Reserve's proposal, please visit the FinReg blog – "Legal Interpretations in Examination Appeals Should be More Transparent" (April 30, 2018).

Attorney-Client Privilege

- **Overview:** Banking sector attention is focused on challenging the federal banking agencies' position that they can bypass the long-established and crucial protections of attorney-client privilege.
- **The Banking Agencies' Position:**
  - The federal banking agencies have asserted that they have the authority to override attorney-client privilege and compel the production of otherwise protected information in both the (1) examination and supervision and (2) enforcement investigation contexts.
  - The agencies have taken this position in engagement with regulated entities, in agency guidance, in public statements and, for the Bureau, in a formal rule.
  - The agencies ground their position in their statutory examination and visitorial powers, as well as an asserted need to obtain privileged information to ensure safety and soundness.
  - The agencies further believe that 12 U.S.C. § 1828(x), which provides that submission of information to an agency does not constitute a waiver of privilege as to any third party, implicitly bolsters this position.
- **Contrast in Practice and Analysis:**
  - The banking agencies' position stands in contrast to the approach of the SEC and the DOJ, both of which have moved away from prior practices which had placed pressure on parties to agree to waivers in order to be considered cooperative. For over a decade, both SEC and DOJ policy have accepted that waiver of privilege is not a necessary element of cooperation, and recognized the importance of respecting and protecting attorney-client privilege.
  - As examined in detail in a memorandum produced by seven law firms in cooperation with a trade organization, available here, the banking agencies' position is contrary to long-standing judicial precedent, which has established that common law privileges cannot be overridden by statute unless Congress explicitly states such an intention, and the agencies' regulatory efficacy arguments are unsustainable and contrary to the policy imperatives underlying the attorney-client privilege.

For more analysis of the attorney-client privilege, please visit the FinReg blog – "Banking Regulators Examination Authority Does Not Override Attorney-Client Privilege" (May 16, 2018).

International Cooperation

- **General Outlook:** U.S. involvement in international standard-setting bodies continues to generate debate, with strong views on both sides.
  - In a June 2018 speech, Vice Chairman for Supervision Quarles strongly defended international efforts to promote financial stability as "often the best way to tackle problems that are global in scope."
  - A Core Principle in President Trump's February 3, 2017 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, and Chairman Powell has maintained this position.
  - In January 2018, a group of Republican senators sent President Trump a public letter criticizing the level of Financial Stability Board 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.
  - FDIC Chairman McWilliams has expressed skepticism toward international cooperation. In remarks two weeks after her confirmation, she stated that she views international bodies such as the Basel Committee "with some suspicion" and that U.S. regulators should be willing to depart from international standards.
- **Statutory Developments:**
  - Section 211 of EGRRCPA seeks to promote greater transparency and accountability regarding U.S. regulators' participation in international insurance regulatory and standard-setting bodies, e.g., by requiring annual reports to relevant Congressional committees from the Federal Reserve Chair and Treasury Secretary.
  - JOBS 3.0 would significantly curtail U.S. participation in the development of international insurance regulatory standards. For example, it would prohibit U.S. representatives from agreeing to international proposals "if the proposed agreement or standard fails to recognize the United States system of insurance regulation as satisfying such proposals."

International Cooperation

- **Other Potential Methods of Change:**
  - The Treasury Banking Report recommends that the 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 Treasury Report issued in February 2018, *Orderly Liquidation Authority and Bankruptcy Reform* (**Treasury OLA Report**), urges strong cooperation with non-U.S. 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.
  - The Treasury Report issued in July 2018, *A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* (**Treasury Fintech Report**), while sounding a note of caution against the premature adoption of international standards in the quickly-evolving fintech space, endorses proactive U.S. engagement with international counterparts to avoid regulatory fragmentation, facilitate cross-border investment and benefit from lessons learned regarding different regulatory approaches.

Tailored Regulation

- **General Outlook:** EGRRCPA requires regulation and supervision to be tailored to a banking organization's business model and risk profile by raising asset size thresholds for many requirements.
  - EGRRCPA raises the statutory thresholds, generally from $50 billion to $250 billion in total consolidated assets, for many of the Federal Reserve's EPS, including resolution planning and single-counterparty credit limits (**SCCL**).
  - On October 31, the Federal Reserve released proposed rules to tailor EPS for U.S. firms above $100 billion in assets and the U.S. banking agencies proposed corresponding tailoring changes to their capital and liquidity rules. Under the proposed rules, the specific requirements applicable to a firm would depend on which of the following Categories the firm falls into:
    - **Category I** – U.S. G-SIB
    - **Category II** – Either:
      - $700 billion or more in assets; or
      - $75 billion or more in cross-jurisdictional activity
    - **Category III** – Either:
      - $250 billion or more in assets; or
      - $75 billion or more in one of nonbank assets, weighted short-term wholesale funding or off-balance sheet exposures
    - **Category IV** – Any other firm with $100 billion or more in assets

Tailored Regulation

- The proposed rules would also apply EPS to certain non-insurance SLHCs that qualify as a Category I, II, III or IV firm.
  - Currently, SLHCs are subject to regulatory capital requirements and the LCR but are not subject to capital planning, supervisory DFAST and other EPS requirements applicable to similarly sized BHCs.
- Still to come:
  - Proposed tailoring changes to capital planning rule
  - Proposed tailoring of EPS, capital and liquidity rules applicable to U.S. IHCs and U.S. subsidiaries of FBOs
    - In his November 14 testimony before the House Financial Services Committee, Vice Chairman Quarles emphasized that FBOs are "a different [breed of] cat" than U.S. banking organizations, suggesting that the categorization thresholds in the FBO proposal may be different than those proposed for U.S. firms.
  - Proposed tailoring changes to resolution planning rules
- In Rep. Waters' November 9 letter, she noted that "Democrats are [also] concerned about preserving small community financial institutions," signaling that regulatory tailoring for community banks and credit unions could continue in 2019.
- For more detail on the targeted relief to capital and liquidity regulations provided by EGRRCPA, see the Capital and Stress Testing and Liquidity slides.
- See our visual memorandum here describing the key changes EGRRCPA makes to the regulation of banking organizations—color coded for those who want to look only at the changes that affect their own organization.

Tailored Regulation

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

	< $10B	≥ $10B, < $50B	≥ $50B, < $100B	Category IV	Category III	Category II	Category I
Recovery Plans							✓
TLAC Requirement							✓
G-SIB Surcharge							✓
Enhanced Supplementary Leverage Ratio							✓
Advanced Approach Risk Weighted Assets						✓	✓
AOCI Included in Basel 3 capital						✓	✓
Company-Run DFAST					**Every 2 years[1]**	**Annual**	**Annual**
Liquidity Coverage Ratio and Net Stable Funding Ratio					**Eligible for Reduction[2]**	✓	✓
Supplementary Leverage Ratio					✓	✓	✓
SCCL					✓[3]	✓[3]	✓
Supervisory DFAST				**Every 2 years**	**Annual**	**Annual**	**Annual**
CCAR[4]				**Quant. Only**	✓	✓	✓
Section 165(d) Resolution Plans[5]				✓	✓	✓	✓
FDIC IDI Plans			✓	✓	✓	✓	✓
Early Remediation Tools			✓	✓	✓	✓	✓
Risk Management Committee[6]			✓	✓	✓	✓	✓
Durbin Amendment (Interchange Fees)		✓	✓	✓	✓	✓	✓
Subject to Regulation by the Bureau	**Certain Products**	✓	✓	✓	✓	✓	✓
Volcker Rule	**Eligible for Exemption**	✓	✓	✓	✓	✓	✓
Prompt Corrective Action Tools	✓	✓	✓	✓	✓	✓	✓

1. A Category III firm would be required to submit internal stress test results to the Federal Reserve as part of its annual capital plan submission but would be required to publicly disclose the results of DFAST company-run stress tests only once every two years.
2. As proposed, a reduced liquidity coverage ratio and net stable funding ratio of between 70 and 85% of the relevant full requirement would apply to Category III firms with less than $75 billion in weighted short-term wholesale funding.
3. A Category II or III firm's aggregate net credit exposure to a single counterparty would be capped at 25% of tier 1 capital, which currently applies under the Federal Reserve's SCCL rule to U.S. BHCs that are not G-SIBs and have $250 billion or more in total consolidated assets.
4. The Federal Reserve will separately propose tailoring changes to capital planning rules.
5. The proposed rules indicate that the Federal Reserve and FDIC will amend their resolution plan rules in the future to tailor the requirements for firms between $100 billion and $250 billion in assets.
6. The proposed rules would adjust the threshold for risk committee and risk management standards to apply to any publicly traded or privately held firm with $50 billion or more in total consolidated assets.

Tailored Regulation

- **Federal Agencies Have Also Been Tailoring Their Regulations:**
  - Many existing regulations use one of the $10 billion and $50 billion asset thresholds established by Section 165 of Dodd-Frank. These regulations are not directly impacted by the revised asset thresholds under EGRRCPA, however, because they were not promulgated under the relevant provision of Dodd-Frank. During the October 2 Senate Banking Committee hearing, Vice Chairman for Supervision Quarles, Comptroller Otting and FDIC Chairman McWilliams agreed to submit written answers regarding whether their respective agencies will conform such other rules to the higher thresholds under EGRRCPA.
  - In September 2018, the OCC proposed a revision to its enforceable recovery planning guidance that would raise the asset threshold at which national banks, federal savings associations and federal branches of FBOs become subject to the OCC's recovery planning requirements from $50 billion to $250 billion in average total consolidated assets.
  - In March 2017, the Federal Reserve raised the asset thresholds indicating presumptive financial stability concerns in banking M&A transactions.
  - The U.S. banking agencies have also proposed and finalized rules to further tailor their capital and stress testing rules to banking organizations' size and operations, as described in more detail in the Capital and Stress Testing slides.
  - See the Foreign Banking Organizations slides for a discussion of tailoring applicable to those entities.

Capital and Stress Testing

- **General Outlook:** U.S. banking agencies have unfinished business in implementing or finalizing U.S. Basel III capital and liquidity requirements, but Vice Chairman for Supervision Quarles has signaled that the intention is not to weaken capital, liquidity or stress-testing requirements, but to make them more transparent, efficient and simple.
  - **Capital**
    - Simplification of Capital Rules for Non-Advanced Approaches Firms – proposed September 2017 (see slide 25)
    - Implementation of Stress Buffer Requirements (**SBR**) – proposed April 2018 (see slides 29–30)
    - Recalibration of enhanced SLR (**eSLR**) – proposed April 2018 (see slide 31)
    - Capital treatment of Current Expected Credit Losses methodology (**CECL**) – proposed 2018 (see slide 32)
    - Standardized Approach for Counterparty Credit Risk (**SA-CCR**) – proposed October 2018 (see slide 32)
    - In his October 2 testimony before the Senate Banking Committee, Vice Chairman for Supervision Quarles said that the G-SIB surcharge will "inevitably" be looked at by the Federal Reserve as part of its review of regulations that apply to those firms and that "it is relevant we try to ensure we have a level playing field internationally."
  - **Stress Testing and Capital Planning (DFAST and CCAR):**
    - The 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.
    - The SBR proposal would also change certain CCAR and DFAST assumptions that could otherwise result in excessive stressed capital requirements for banking organizations that are subject to the DFAST and CCAR programs.
    - In a November 9 speech at the Brookings Institution, Vice Chairman for Supervision Quarles said that the SBR proposal would be modified in response to "extensive and thoughtful" comments, and delayed past the start of the 2019 CCAR and DFAST cycle.

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

Capital and Stress Testing

- **Simplification of Capital Rules for Non-Advanced Approaches Firms:** In September 2017, the U.S. banking agencies proposed simplifying certain aspects of their Basel III capital rules and making some technical corrections to them. The simplification proposals would affect non-advanced approaches banking organizations and would result in the following changes:
  - **Simplified Treatment of Threshold Deduction Items:** For mortgage servicing assets (**MSAs**), temporary difference deferred tax assets (DTAs), and significant investments in unconsolidated financial institutions, the proposal would:
    - Replace the 10% of CET 1 capital deduction thresholds for each category with 25% of CET 1 capital thresholds
    - Eliminate the distinction between significant and non-significant investments in unconsolidated financial institutions and treat all investments in unconsolidated financial institutions as subject to a single 25% of CET 1 capital threshold
    - Eliminate the aggregate 15% of CET 1 threshold for the combined impact of the three categories of deduction items
    - Risk weight MSAs and temporary difference DTAs that are not deducted from CET 1 capital at 250%
    - Risk weight investments in the capital of unconsolidated financial institutions that are not deducted from CET 1 capital according to the relevant treatment of the exposure under the capital rules (i.e., for equity exposures, ranging from 100% for non-significant equity exposures to 300% or 400% for publicly traded and non-publicly traded equity exposures, respectively)
  - **Simplified Treatment of Minority Interests:** The proposal would permit the recognition of minority interests issued by consolidated subsidiaries up to 10% of the relevant tier of capital after all other deductions and adjustments, but before recognition of minority interests (i.e., up to 10% of the firm's CET 1 capital for CET 1 capital instruments issued by the subsidiary to third parties, up to 10% of the firm's Tier 1 capital for Tier 1 capital instruments issued by the subsidiary to third parties, etc.), and without having to calculate the extent to which the subsidiary's minority interests may reflect excess capital at the subsidiary.
  - **Delay in Final Phase-in of Capital Rules for Non-Advanced Approaches Firms**: In November 2017, in keeping with the capital simplification proposal, the U.S. banking agencies finalized a rule to indefinitely delay, for non-advanced approaches banking organizations, the final phase-in step of the transition provisions of the capital rules that would be affected by the proposal.

Capital and Stress Testing

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

- **Statutory Developments:** EGRRCPA makes the following changes to the **U.S. Basel III capital rules**:
  - **SLR for Custody Banks:** EGRRCPA directs the U.S. banking agencies to exclude certain central bank deposits from the total leverage exposure (the SLR denominator) of custody banks, defined as "depository institution holding companies predominantly engaged in custody, safekeeping and asset servicing activities," together with their insured depository institution subsidiaries.
    - Central bank reserves of custody banks will be excluded only to the extent of the value of customer deposits that are linked to fiduciary, custody or safekeeping accounts.
    - Vice Chairman for Supervision 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.

Capital and Stress Testing

- **Community Bank Leverage Ratio / Off Ramp:** EGRRCPA directs the U.S. banking agencies to establish via rulemaking a community bank leverage ratio, and banking organizations that exceed this leverage ratio will be deemed to have met their applicable leverage ratios, risk-based capital ratios, well-capitalized minimums for prompt corrective action and any other applicable capital or leverage requirements.
  - A bank or BHC will 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 will 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%.
  - In testimony before the Senate Banking Committee on October 2, FDIC Chairman McWilliams stated that she expects the U.S. banking agencies to issue a proposed rule implementing the community bank leverage ratio by the end of the year, and Vice Chairman for Supervision Quarles confirmed that the Federal Reserve aims to release such a proposal "in the very near future."
- **Capital Treatment of Commercial Real Estate Exposures:**
  - On September 18, the U.S. banking agencies proposed a rule that would substantively replace the current definition of an High Volatility Commercial Real Estate (**HVCRE**) exposure in the capital rules with EGRRCPA's definition of a high volatility commercial real estate acquisition, development, or construction (**HVCRE ADC**) loan. This proposed rule would:
    - Be a copy-and-paste from the statute, with no additional interpretive guidance or clarifications in the relevant rule text – meaningfully reducing the clarity of the U.S. Basel II capital rules
    - Continue to apply a 150% risk weight to HVCRE exposures, as newly redefined, under the standardized approach
    - Exempt any loan made prior to January 1, 2015 – the date the original heightened risk weight for HVCRE exposures went into effect – from the new definition of an HVCRE exposure, as required by EGRRCPA
    - Apply the general 100% risk weight to non-HVCRE exposures, unless another lower or higher risk weight otherwise applies

Capital and Stress Testing

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

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

See the Tailored Regulation slides above for a description of Categories I through IV.

- Although a Category III firm would be required to publicly disclose the results of its DFAST company-run stress tests only once every two years, it would still be required to submit internal stress test results annually to the Federal Reserve as part of its capital plan submission.
- The proposed rules would not change the company-run DFAST threshold applicable to banks and savings associations. The Federal Reserve indicated that it would propose corresponding changes for state member banks in a later release, and we expect the other agencies to follow suit.

Capital and Stress Testing

- EGRRCPA changes to the DFAST and CCAR requirements also include:
  - **Number of Dodd-Frank Act Stress Test Economic Scenarios:** EGRRCPA also reduces the required number of economic scenarios from three to two, eliminating the middle-of-the-road adverse scenario and leaving the baseline and severely adverse scenarios.
  - **Timing of CCAR and DFAST Threshold Changes:**
    - On October 31, the Federal Reserve and other U.S. banking agencies issued proposed rules that would adjust the thresholds applicable to BHCs' company-run and supervisory DFAST requirements.
      - BHCs with less than $100 billion in total consolidated assets are exempt from both DFAST and CCAR for the 2018 cycle, as expected.
      - The proposed rules would remove the mid-cycle company-run stress test for all BHCs, including G-SIBs, effective in the 2020 cycle.
      - The proposed rules also stated that Federal Reserve and U.S. banking agencies, as appropriate, will issue proposed rules to align CCAR requirements for BHCs and company-run DFAST requirements for non-BHC companies, including banks, in the future.
- **Other Potential Methods of Change**:
  - **Stress Buffer Requirements**: In April 2018, the Federal Reserve released a proposed rule on the implementation of the SBR that would fundamentally change how stress testing is used to impose capital requirements for large BHCs.
    - The SBR proposal would eliminate the ability of the Federal Reserve to object to a capital plan on quantitative grounds, and instead incorporate stress losses directly into a firm's point-in-time capital requirements by replacing the 2.5% fixed portion of the capital conservation buffer with a new stress capital buffer (**SCB**) equal to a firm's peak-to-trough stress losses, on top of the G-SIB surcharge and any applicable countercyclical capital buffer.
    - The SBR proposal would incorporate four quarters of planned dividends based on a firm's baseline projections to the calibration of the SCB.
    - The SBR proposal would also modify several assumptions in the CCAR framework to better align them with a firm's expected actions under stress, including a constant rather than growing balance sheet.

Capital and Stress Testing

Modifications Coming:

- As proposed, the SBR proposal would have been effective in time for the 2019 CCAR and DFAST cycle. In his November 9 speech at the Brookings Institution however, Vice Chairman for Supervision Quarles said that the SBR proposal would be modified in response to "extensive and thoughtful" comments and delayed past the start of the 2019 CCAR and DFAST cycle.
  - Quarles stated that his foremost concern is the volatility of stress test results. He stressed the need to balance between ensuring that firms have sufficient notice of changes in their capital requirements and preserving the supervisory ability to adapt the stress tests to changing macroeconomic conditions and an evolving understanding of the salient risks.
  - Quarles also previewed other modifications to the SBR proposal, including:
    - Modifying the market shock framework applicable to the six firms with the most significant trading activity to utilize more stress scenarios, rather than a single stress scenario;
    - Modifying the timing of the requirement to submit final capital distribution plans relative to the release of the supervisory stress test results, including the annual recalibration of firms' SCB requirements;
    - Alternatives to the dividend add-on component of the SCB calibration; and
    - Eliminating the stress leverage buffer so that risk-insensitive leverage requirements serve as a back-stop to risk-based requirements, as intended.

Multi-Step Approach:

- Quarles stated in the Brookings Institution speech that the SBR would be finalized in two steps:
  - First, a final rule implementing "the basic framework" of the SCB expected in the near future.
  - Second, a re-proposal of "certain elements" of the SBR proposal, with these elements to be finalized at a later date.
  - Based on this timing, the first SCB would become effective starting with the 2020 CCAR and DFAST cycle.

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

Capital and Stress Testing

- **Other Potential Methods of Change:**
  - **Stop-Gap Modifications to 2019 CCAR and DFAST:** In Vice Chairman for Supervision Quarles' November 9 speech, he stated that he would seek to modify certain elements of the 2019 CCAR quantitative assessment, given the delay in finalizing the SBR proposal and the recently proposed rules to tailor EPS in accordance with EGRRCPA.
    - Quarles stated that he will ask the Federal Reserve Board to exempt firms with less than $250 billion in assets from the 2019 CCAR quantitative assessment and supervisory DFAST, in light of the proposed biennial frequency for these requirements for Category IV firms under the tailoring proposal.
    - Quarles stated that the Federal Reserve will consider whether the any of the SCB proposal's modified CCAR assumptions could be implemented for the 2019 CCAR cycle, including relaxing the assumption that firms' balance sheets would grow during the severely adverse stress scenario.
  - **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 Total Loss Absorbing Capacity (**TLAC**) and long-term debt requirements for U.S. G-SIBs and invited comment on whether to recalibrate the TLAC SLR and long-term debt SLR to reflect more closely the capital refill framework and to eliminate U.S. goldplating relative to international standards.
    - Vice Chairman for Supervision Quarles stated in his April testimony to the House Financial Services Committee that the objective of the eSLR calibration is to make sure that the eSLR is not a primary binding capital measure.

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

Capital and Stress Testing

- **Other Potential Methods of Change:**
  - **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.
  - 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.
  - **SA-CCR**: In October 2018, the Federal Reserve, the FDIC and the OCC released a joint proposed rule the would implement the standardized approach for counterparty credit risk (**SA-CCR**), a new standardized methodology for calculating the exposure amount for derivative contracts under the U.S. Basel III capital rules. The new SA-CCR methodology under the proposal would generally track the Basel Committee's version of SA-CCR finalized in 2014, which reflects a more risk sensitive approach than the existing current exposure method (**CEM**).
    - The proposal would require advanced approaches banking organizations to use SA-CCR to measure counterparty credit risk for derivatives, in lieu of CEM.
    - The proposal would permit non-advanced approaches banking organizations to use either SA-CCR or CEM to measure counterparty credit risk for derivatives.
    - The proposal would also make conforming changes incorporating the new SA-CCR methodology to other requirements related to derivative exposures, such as determining exposure amounts for cleared derivatives, calculating the risk-weighted asset amount for default fund contributions to CCPs, and measurements of off-balance sheet exposures related to derivatives under the SLR.
    - The proposal would also indirectly affect the measurement of exposure concentrations for purposes of the SCCL requirements.

Liquidity

- **General Outlook:**
  - **Net Stable Funding Ratio** (**NSFR**) – proposed June 2016; Vice Chairman for Supervision Quarles stated during the Q&A after a May 16 speech that the Federal Reserve intends to propose a final rule in the near future.
  - **LCR applicability to FBO IHCs?** – An IHC of an FBO is not currently subject to the LCR rule. However, the Federal Reserve stated in its 2014 final rule that it anticipates a future separate rulemaking to implement an LCR-based standard for the U.S. operations of all or a subset of FBOs with ≥ $50 billion in combined U.S. assets. They did not indicate whether such a future standard might apply to U.S. branches and agencies of FBOs.
- **Statutory Developments:** EGRRCPA makes the following changes to the **U.S. Basel III liquidity rules**:
  - **Treatment of Municipal Securities under the LCR**: As required by EGRRCPA, the U.S. banking agencies have released an interim final rule amending the LCR to expand the eligibility of investment grade municipal obligations as Level 2B high-quality liquid assets.

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

TLAC

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

For more information on TLAC, please visit the FinReg blog – "Federal Reserve May Simplify the TLAC Rule" (Jan. 30, 2018).

Foreign Banking Organizations

- **General Outlook:** EGRRCPA provides regulatory relief to FBOs under certain asset thresholds. The Federal Reserve announced its intent to issue a proposal to tailor its regulations for foreign banks, consistent with EGRRCPA.
- **Statutory Developments:**
  - EGRRCPA increases the statutory threshold for most of the Federal Reserve's EPS to $250 billion in total consolidated assets.
  - As passed by Congress, EGRRCPA clarifies that nothing in the provision raising the EPS asset thresholds:
    - Affects the application of the Federal Reserve's existing EPS regulations to an FBO with $100 billion or more in global total consolidated assets
    - Limits 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
- **Regulatory Developments:**
  - The Federal Reserve's inaugural Supervision and Regulation Report, published in November 2018, highlighted concerns about FBOs.
    - The report noted that, contrary to a general downward trend in outstanding supervisory findings at large financial institutions, MRAs and MRIAs have increased for large FBOs.
    - The report stated that FBOs continue to face challenges regarding compliance with EPS, including the IHC requirement and risk management and reporting systems requirements.
  - The proposed tailoring rules issued on October 31 did not address FBOs, but the Federal Reserve stated that "[a] separate tailoring proposal affecting foreign banks will be released in the future." Vice Chairman for Supervision Quarles stated in his November 14 testimony before the House Financial Services Committee that the proposal would be released early in 2019.
  - Vice Chairman for Supervision Quarles stated in his October 2 testimony before the Senate Banking Committee that the Federal Reserve is "not including any changes to the FBO regulatory scheme for FBOs with more than $250 billion in global assets as part of [its] implementation of tailoring mandated by [EGRRCPA]."

Foreign Banking Organizations

- In an August 2018 letter to Vice Chairman for Supervision Quarles, a group of Senators, including members of the Senate Banking Committee, called on the Federal Reserve to provide U.S. IHCs of FBOs with “comparable regulatory treatment to U.S. BHCs of similar size and risk profile” under any rules implementing EGRRCPA.
- The Federal Reserve confirmed in a July 2018 policy statement that it will not take action to require any FBO with global total consolidated assets of less than $100 billion to comply with the general EPS requirements or with certain reporting, disclosure and recordkeeping requirements.
- In the preamble to the SCCL final rule, the Federal Reserve noted that it interprets EGRRCPA to have “restrict[ed] the scope of application of most [EPS] . . . to . . . FBOs with $250 billion or more in total consolidated assets.”
  - The SCCL final rule applies only to the U.S. operations and U.S. IHCs of FBOs with $250 billion or more in global total consolidated assets.
  - The preamble to the SCCL final rule noted that the Federal Reserve may, through a separate rulemaking, apply the SCCL to FBOs and U.S. BHCs with $100 billion or more but less than $250 billion in global total consolidated assets.

- **Other Potential Methods of Change:**
  - The Treasury Banking Report recommends:
    - Increasing the threshold at which an FBO’s U.S. IHC becomes subject to CCAR
    - 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
  - Those Treasury Banking Report recommendations could be effected by the Federal Reserve through revisions of its regulations (e.g., its CCAR and TLAC rules).
  - Vice Chairman for Supervision 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.

Foreign Banking Organizations

- The following chart summarizes the Federal Reserve's current approach to implementing EGRRCPA with respect to FBOs based on their global total consolidated assets.

	FBO ≥ $10B, < $50B globally	FBO ≥ $50B, < $100B globally	FBO ≥ $100B globally
Risk committee requirement	**Exempt**	Still Applies	Still Applies
DFAST company-run stress testing	**Exempt**	**Exempt**	Still Applies
Resolution planning	N/A	**Exempt**	Still Applies
Debt-to-equity limits	N/A	**Exempt**	Still Applies
Home country / Basel III risk-based and leverage capital, liquidity risk management and capital and liquidity stress testing requirements, as applicable	N/A	**Exempt**	Still Applies
Additional EPS requirements – e.g., TLAC, U.S. IHC – as applicable	N/A	N/A	Still Applies

Orderly Liquidation Authority

- **General Outlook:** The risk that Orderly Liquidation Authority (**OLA**) will be repealed is eliminated, at least for now, with an incoming Democratic House majority. A new chapter 14 of the Bankruptcy Code could be enacted, but it is more likely to be enacted as an addition to OLA rather than as a replacement for it.
  - Democrat Rep. Waters, likely to be the incoming Chairwoman of the House Financial Services Committee, expressed opposition to repealing OLA in her November 9 letter.
  - 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, Chairman 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 in July 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."
  - At a TCH/SIFMA conference on June 19, Senator Toomey stated that while he was still against OLA, he accepted that it would make sense to first reform the Bankruptcy Code and only later consider changes to or repeal of OLA.

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

Orderly Liquidation Authority

- **Potential Methods of Change:**
  - The Financial Institutions Bankruptcy Act, which is based on the Hoover Institution's Chapter 14 proposal and would add a new Subchapter V (aka **Chapter 14**) to Chapter 11 of the Bankruptcy Code, passed the full House in 2016 and 2017.
    - Chapter 14 would facilitate SPOE resolution strategies for large financial companies by:
      - Facilitating the transfer of assets from a failed holding company to a bridge company to allow the continuing operation of operating subsidiaries outside of bankruptcy
      - Overriding cross-default rights in qualified financial contracts entered into by subsidiaries if certain conditions are satisfied, which is consistent with the ISDA Protocol
      - Providing a safe harbor from avoidance actions for transfers of assets to recapitalize the operating subsidiaries
    - The Treasury OLA Report also recommends that Chapter 14 be added as a preferred alternative to OLA, not a replacement.
  - OLA could be amended to impose clear limits on the FDIC's discretion, including its discretion to use the Orderly Liquidation Fund for anything other than fully secured loans to recapitalized and otherwise solvent firms at premium rates; the Treasury OLA Report recommends such reforms.
  - The FDIC could issue additional guidance or regulations to clarify certain aspects of OLA, even absent a statutory change.
  - In conjunction with a November 13 hearing of the Senate Judiciary Committee, Democratic Senator Coons stated that he is working with Republican Senator Cornyn and others to draft bipartisan legislation addressing bankruptcy of large financial institutions. Senator Coons indicated that his legislation would depart from prior draft Chapter 14 bills in some respects and would not replace OLA.

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 Federal Reserve and FDIC jointly issued proposed guidance for the U.S. G-SIBs' 2019 and subsequent living wills submissions on June 29, and additional proposed guidance is expected. A proposed rule to tailor living wills requirements is also expected.
- **EGRRCPA:** EGRRCPA raised 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.
  - In a July 2 press release, the Federal Reserve and FDIC noted that, pursuant to EGRRCPA, the Federal Reserve, in the next 18 months, will determine which firms with more than $100 billion but less than $250 billion in total consolidated assets will be subject to the living will requirement going forward.
  - In a memo accompanying the proposed tailoring rules issued on October 31, Vice Chairman for Supervision Quarles stated that the Federal Reserve and FDIC staff would soon issue a separate proposal to appropriately tailor living wills requirements. Vice Chairman for Supervision Quarles has previously stated that he supports reducing the information burden of living wills submissions on "firms with less significant systemic footprints."
- **The Financial Institution Living Will Improvement Act**
  - The Financial Institution Living Will Improvement Act, which passed the House in January 2018 with unanimous support and is included in JOBS 3.0, would enshrine in statute many of the changes recommended in the Treasury Banking Report (see below), including moving to a two-year submission cycle for the Title I plans and requiring feedback on submissions within six months.
  - It is unclear if the Republican-controlled Senate will take any action on JOBS 3.0 in the upcoming legislative session.

Living Wills

- **Key Regulatory Developments:** The Treasury Banking Report recommends that the agencies move to a two-year cycle for living wills submissions, subject the living wills guidance and assessment framework to public notice and comment, and require feedback on living wills within six months. While the outcome of statutory efforts to make some of these changes (i.e. JOBS 3.0) is unclear, agency actions and comments from key regulators have tracked these proposed modifications.
  - 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 and did not identify any deficiencies in any of the U.S. G-SIBs 2017 165(d) plans. The Federal Reserve and FDIC also extended the deadline for living wills filers with a December 2018 deadline to December 2019.
  - Notice and Comment
    - On June 29, 2018 the Federal Reserve and FDIC issued and invited comments on proposed guidance for the 2019 and subsequent submissions of the U.S. G-SIBs' living wills.
    - Vice Chairman for Supervision Quarles had previously stated, in a May 16 speech and Q&A, that the Federal Reserve intends to subject all of the previous guidance provided to U.S. and foreign firms on their living wills to the public notice and comment process of the Administrative Procedure Act, including guidance on capital and liquidity adequacy and positioning
- **Status of the IDI Plan Rule**
  - The IDI solo rule is not affected by the passage of EGRRCPA.
  - The Treasury Banking Report recommended that the FDIC be removed from the Section 165(d) living will process, although there are no apparent statutory or regulatory efforts underway to accomplish this.

For more information on the June proposed guidance, please visit the FinReg blog – "Federal Reserve and FDIC Issue Proposed Guidance on U.S. G-SIBs' 2019 Resolution Plan Submissions" (June 29, 2018).

Volcker Rule

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

Volcker Rule

- Limited proposed amendments to covered funds portion of the regulations, but the agencies invited comment on a wide range of issues, including the definition of "covered fund" and whether the exceptions to the definition of covered transaction under section 23A of the Federal Reserve Act and Reg W should be incorporated into the definition of covered transaction under Super 23A
- Elimination of Appendix B and modifications to Appendix A, including new qualitative informational requirements

- **See our visual memorandum here for further analysis of the proposed amendments.**
- **EGRRCPA:**
  - Enacts the community bank exemption:
    - Exempts from the Volcker Rule any IDI and any affiliate of an IDI that meets, and is not controlled by a company that does not *itself* meet, the following requirements:
      - ≤ $10 billion in total consolidated assets; and
      - Total trading assets and trading liabilities of 5% or less of total assets

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

Community Reinvestment Act

- **Change is Coming:** Leadership at the Treasury Department, OCC, FDIC and Federal Reserve have strongly signaled support for revising the Community Reinvestment Act (**CRA**) regulatory framework.
  - Based on public statements, however, there is not yet consensus on how to accomplish that reform.

Treasury Department	OCC	FDIC	Federal Reserve
• In April 2018, the Treasury Department issued a memo recommending that CRA reform efforts focus on updating assessment areas, improving the clarity, flexibility and timeliness of performance evaluations, and re-evaluating penalties for nonperformance.	• The OCC, without sign-on from the Federal Reserve or the FDIC, released an ANPR "to solicit ideas for building a new framework to transform and modernize" the current CRA regulatory framework to better achieve the statutory purpose of the CRA. Comments are due November 19, 2018. • The ANPR is closely aligned with both (1) the April 2018 Treasury Department memo and (2) Comptroller Otting's June 2018 testimony before the House Financial Services and Senate Banking Committees (see slide 46 for more details on Otting's framework for CRA reform). • While offering few concrete proposals, the ANPR asks questions relating to CRA performance evaluations, the definition of assessment area and CRA-qualifying activities.	• Indicating a preference for a moderate approach to CRA reform, Chairman McWilliams has defended the importance of branches in low- and moderate-income communities to the extent that consumers rely on branches in these areas more than they rely on digital services. • In a nod to cooperation, the FDIC has indicated that it will join in a proposed rulemaking and downplayed the significance of the OCC acting on its own.	• Vice Chairman for Supervision Quarles agrees with FDIC Chairman McWilliams that, despite the evolution of the financial system, physical branches of banks still play an important role in certain communities and CRA reform must take this into account. • The Federal Reserve will be holding a series of roundtables across the country on the CRA and plans to make public its findings from the initiative. • The Federal Reserve, although it did not join in the ANPR, will be reading the comment letters in anticipation of a joint proposal.

Community Reinvestment Act

- **Democratic Points of View:**
  - Federal Reserve Governor Brainard has spoken extensively about the CRA in recent months; while broadly agreeing with the need for change, she has indicated a desire to moderately adjust the current regulatory framework as opposed to following the transformational, metric-based approach outlined by the OCC.
    - At odds with Comptroller Otting's vision, Governor Brainard has expressed support for tailored regulation based on bank size and business model.
  - In a letter to the Federal Reserve, OCC and FDIC, 16 Democratic senators led by Senator Warner outlined:
    - Support for Treasury's recommendation to update geographic assessment areas
    - Opposition to the adoption of OCC policies that permit banks with less than satisfactory CRA ratings to open or acquire new branches and require a direct relationship between a discriminatory or illegal credit practice and the bank's CRA lending activities for there to be a ratings impact
  - Further, Senator Warren has:
    - Introduced a bill that would extend the applicability of CRA requirements beyond FDIC-insured banks to credit unions and nonbank mortgage originators and increase the severity of penalties for CRA violations
    - Asserted that the OCC's ANPR proposals indicate a desire to weaken the CRA, which Comptroller Otting argued is inaccurate
      - In a letter to Comptroller Otting, nine Democratic senators led by Senator Brown expressed concern about recent changes to evaluation practices that they believe weaken CRA enforcement. They focused on the lengthening of the performance evaluation cycle for certain banks from 36 to 48 months and the policy of not delaying the issuance of CRA evaluations if pending matters involving potentially discriminatory practices cannot be resolved within 90 days.

For more information on the CRA, visit the FinReg blog – "CRA Reform: The OCC Is the First and (So Far) Only Regulator Out of the Gate" (Aug. 31, 2018) and "Treasury Offers Roadmap to CRA Reform" (Apr. 10, 2018).

Community Reinvestment Act

Comptroller Otting's Framework for CRA Reform

1 Expand CRA-Qualifying Activities

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

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

2 Broaden Assessment Areas

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

3 Develop Metrics-Driven Evaluation Approach

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

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

$$\frac{\$\ \text{Total CRA Activities}}{\$\ \text{Total Assets or Total Tier 1 Capital}}$$

Anti-Money Laundering

- **General Outlook:** While regulatory change is a high priority for Comptroller Otting, we still 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 anti-money laundering (**AML**) violations, including violations of compliance standards.
    - Political and regulatory climate suggests that these efforts will continue, and potentially accelerate.
  - On May 11, 2018, FinCEN's Customer Due Diligence (**CDD**) rule became applicable after a two-year implementation period. The CDD Rule added a new requirement for covered financial institutions to identify, and verify the identity of, the beneficial owners of certain of their legal entity customers. It also clarified and enhanced CDD requirements for financial institutions.
  - In contrast, Congress continues to consider the scope and impact of the CDD rule, and the Counter Terrorism and Illicit Finance Act moving through Congress recently dropped its beneficial ownership requirement.
  - In addition, the banking agencies are taking note that an AML framework for virtual currencies has yet to be put in place, and will need to be developed as the technology evolves.
  - AML/BSA compliance has also been identified as a supervisory priority for state member banks and FBOs in the Supervision and Regulation Report issued by the Federal Reserve in November.
- **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.
  - Strong policy imperatives continue to underlie the general federal AML framework. In May, federal banking regulators met to discuss improvements to the current AML laws and regulations.

Bank Secrecy Act

- **General Outlook:** Changes to the Bank Secrecy Act (**BSA**) and other AML rules are being seriously discussed, and Comptroller Otting has made it clear that reform in this area is one of his top priorities. Legislative change is uncertain.
  - A recent BPI empirical study of the U.S. AML/CFT regime, *Getting to Effectiveness – Report on U.S. Financial Institutions Resources Devoted to BSA/AML & Sanctions Compliance*, found that financial institutions have invested approximately $2.4 billion on AML/CFT compliance, and in 2017, reviewed 16 million alerts leading to the filing of 640,000 SARs and 5.2 million CTRs.
    - In addition, only 4% of SARs and 0.44% of CTRs filed by financial institutions are deemed useful by law enforcement.
    - A central recommendation of the study is that Treasury should have a more prominent role in coordinating AML/CFT policy and examinations, as well as lead a multi-agency review of the AML/CFT regime in order to prioritize the reporting of activities that provide effective, useful information to law enforcement.
- **Potential Methods of Change:**
  - The OCC, the Federal Reserve, the FDIC, the National Credit Union Administration and FinCEN are discussing potential changes to the BSA and other AML rules within the next three to six months, with an eye toward rationalizing compliance requirements for banks and other financial institutions. Such changes could include:
    - Allowing regulators to schedule and scope BSA/AML examinations on a risk-basis and identifying ways to conduct associated examinations in a more efficient manner
    - Considering changes to the threshold requiring mandatory reporting of Suspicious Activity Reports (**SARs**) and currency transaction reports and simplifying reporting forms and requirements
    - Working with law enforcement to provide feedback to banks so that they understand how SARs and other BSA report filings are used and can provide the most useful information
    - Exploring the use of technologies to reduce reporting burden and provide more effective access and information to law enforcement and national security personnel
  - On October 3, 2018, the OCC, Federal Reserve, FDIC, NCUA, and FinCEN issued an interagency statement to address ways in which small banks and credit unions can collaborate in order to share resources to manage their BSA/AML obligations.

For more information, please visit the FinReg blog – "One Small Step for AML: Federal Banking Regulators Issue Joint Statement on BSA/AML Resource Sharing" (Oct. 8, 2018).

OFAC Sanctions

- **General Outlook:** Under the Trump Administration, there have been significant developments with respect to sanctions against Iran, Russia, North Korea and Cuba. The sanctions regimes against these countries have generally been strengthened through a combination of executive and legislative action.
  - The Countering America's Adversaries through Sanctions Act (**CAATSA**), which provides authority for additional sanctions against Iran, Russia, and North Korea, was signed into law on August 2, 2017.
- **Iran**
  - A rollback of the Iran nuclear deal – the Joint Comprehensive Plan of Action (**JCPOA**) and Iran sanctions – is currently underway.
  - 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 reimposing 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.
    - The first wave of U.S. sanctions were reimposed on August 7, 2018. The EU responded by imposing a "blocking statute" designed to protect European businesses that trade with Iran and reiterated their commitment to the JCPOA.
    - On November 5, 2018, all U.S. sanctions (both primary and secondary) that had been waived or lifted under the JCPOA have been reimposed and are in full effect. The State Department granted "significant reduction" exceptions to eight countries, allowing them to continue – at least temporarily – importing Iranian oil and engaging in a limited range of transactions with certain Iranian banks.

For more information on developments regarding economic sanctions, please see our client memorandum – "U.S. Government Fully Re-Imposes Iran Sanctions, Announces 'Unprecedented' Sanctions Effort as it Moves on from the JCPOA" (Nov. 6, 2018), and visit the FinReg blog's Economic Sanctions section here, including – "As Sanctions 'Snap-Back' Approaches, FinCEN Advisory Emphasizes Risks to the U.S. and International Financial Systems Posed by Iran" (Oct. 15, 2018), "OFAC Enforcement Highlights Risk of Indirect Sanctions Violations, Importance of Acting on 'Red Flags'" (Oct. 9, 2018).

OFAC Sanctions

- **Russia**
  - The Russia sanctions make up the bulk of CAATSA, which 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 seven 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. OFAC has subsequently taken action to ameliorate some of the effects of these sanctions on U.S. persons, including by issuing general licenses related to the sanctioned Russian entities EN+ Group plc and RUSAL PLC.
  - On August 8, 2018, the Trump Administration announced that they were imposing sanctions against Russia under the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991. The first round of sanctions includes additional restrictions on the export of dual-use technologies and took effect on August 27. On November 6, the State Department informed Congress that they could not certify Russia's compliance with the Act, paving the way for potential new sanctions.

For more information on developments regarding economic sanctions, please visit the FinReg blog's Economic Sanctions section here, including – "Russia Sanctions Updates" (Sept. 24, 2018) and "OFAC Targets Russian Oligarchs and Government Officials" (April 6, 2018).

OFAC Sanctions

- **North Korea**
  - 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 Executive Order 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.
    - 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.
  - In February 2018, the Administration announced the latest and "largest North Korea-related sanctions tranche to date…to further isolate the [North Korean] regime and advance the U.S. maximum pressure campaign." The sanctions include designations against seven Chinese and Hong Kong companies.
  - President Trump met Kim Jong-un in Singapore to discuss the security situation on the Korean Peninsula, including with respect to North Korea's nuclear and ballistic missile program, on June 12, 2018. The ultimate effect of this summit on North Korea sanctions is unclear.
- **Cuba**
  - President Trump announced Cuba sanctions policy changes in June 2017, which will reinstate certain limits on education 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.

Derivatives

- **General Outlook:** Incremental changes to the OTC derivatives regime have occurred and are likely to continue to occur incrementally through rulemakings, no-action letters and guidance.
- **CFTC Spots Now Filled with Trump Appointees**
  - With the swearing in of Dan Berkovitz and Dawn Stump as Commissioners of the CFTC in early September 2018, for the first time since 2014, there are no vacancies in the agency's five member commission. Chairman Giancarlo, who had been appointed to the CFTC by President Obama, was appointed by President Trump to the chairmanship, and all four of the other commissioners are Trump appointees.
  - Chairman Giancarlo has announced that he will not seek reappointment when his term expires in April 2019.
- **Significant Regulatory Initiatives**:
  - Since the election, the CFTC has:
    - Launched Project KISS (**Keep it Simple, Stupid**), an agency-wide internal review focused on simplifying and modernizing CFTC rules, regulations and practices, and issued a related request for public input
    - Initiated a comprehensive review of the CFTC's swap data reporting regulations
    - Established LabCFTC, an initiative aimed at promoting responsible fintech innovation
    - Issued determinations finding that the EU and Japanese margin requirements for uncleared OTC derivatives are comparable to the CFTC's uncleared swap margin rules

Derivatives

- **Recent Final Rulemakings**: In August 2018, as part of its Project KISS program, the CFTC approved a final rule that clarifies Chief Compliance Officer (**CCO**) roles and responsibilities, reduces burdens on CCOs and uncertainty for registrants, and harmonizes certain provisions with SEC rules.
    - In November 2018, the CFTC made permanent the $8 billion swap dealer *de minimis* registration threshold.
- **Recent Rule Proposals:** The CFTC has proposed significant rulemakings in a number of areas, including:
    - In November 2018, the CFTC proposed amendments to the rules governing swap execution facilities (**SEFs**), including changes that would expand the scope of products subject to the trade execution requirement, permit trade execution by any means available to the SEF and broaden the types of entities required to be registered as SEFs.
    - In October 2018, as part of the Project KISS initiative to reduce unnecessary burdens on registrants and market participants, the CFTC issued a proposed rule that would amend registration and compliance requirements for commodity pool operators (**CPOs**) and commodity trading advisors by codifying certain staff letters and advisories that, among other things, streamline registration and compliance requirements for CPOs that operate in multiple jurisdictions, prohibit statutorily disqualified persons from operating exempt pools and provide registration relief for qualifying family offices and investment advisers of business development companies.
    - In July 2018, as part of the Project KISS initiative, the CFTC issued a proposed rule that would amend reporting requirements to simplify notification of counterparties of their right to segregate initial margin for uncleared swaps and modify requirements for the handling of segregated initial margin.

For more information, please see the FinReg Blog – "CFTC Adopts Final Rule Amendments Simplifying CCO Duties and Annual Report Rules for FCMs, Swap Dealers and MSPs" (Aug. 29, 2018).

Derivatives

- **SEC Rulemaking**: On October 11, the SEC reopened the comment period and requested additional comments for previously proposed rules relating to capital, margin, and segregation requirements for security-based swap dealers (**SBSDs**), major security-based swap participants (**MSBSPs**) and, in some cases, broker-dealers.
  - Adoption of these rules is an important predicate to the implementation of other security-based swap rules.
  - The date on which SBSDs will be required to register with the SEC and comply with various requirements, including business conduct standards and trade acknowledgement and verification requirements:
    - Will not occur until at least six months after the Federal Register publication of the final capital, margin, and segregation rules
    - Is also contingent upon the finalization of additional rules, including the occurrence of the compliance date for final rules regarding recordkeeping and financial reporting requirements for SBSDs and MSBSPs
- **CFTC/SEC Coordination:** In June 2018, the CFTC and SEC entered into a memorandum of understanding that "will help ensure continued coordination and information sharing between the two agencies" and specifically mentions cooperation regarding the Dodd-Frank Title VII swaps regime.
  - In his July 2018 testimony before the House Committee on Agriculture, Chairman Giancarlo noted his agreement with SEC Chairman Clayton to prioritize the harmonization of Title VII rules, dividing the issues into two categories – "[S]imple practical ones" including filing of forms and harmonizing margin requirements, which he expected could be completed within months; and longer term issues relating to harmonization around core requirements of swaps execution, swaps reporting and swaps clearing, which will require longer-range work.

For more information, please see the FinReg Blog – "SEC Reopens Comment Period for Security-Based Swap Capital, Margin and Segregation Rules" (Oct. 12, 2018).

Derivatives

- **International Cooperation and Cross-Border Rules:** On October 1, Chairman Giancarlo issued a white paper entitled "Cross-Border Swaps Regulation Version 2.0: A Risk Based Approach with Deference to Comparable Non-U.S. Regulation," setting out guiding principles for the CFTC in interpreting its statutory authority to regulate cross-border swaps activities. The white paper recommends five specific areas for reform:
  - Expansion of the use of the CFTC's exemptive authority for non-U.S. CCPs that are subject to comparable regulation in their home country and do not pose substantial risk to the U.S. financial system
  - Ending the bifurcation of the global swaps markets into separate U.S. person and non-U.S. person marketplaces by exempting non-U.S. trading venues in jurisdictions with comparable G20 swaps reforms from having to register with the CFTC as a swap execution facility
  - Requiring registration of non-U.S. swap dealers whose activity poses a "direct and significant" risk to the U.S. financial system and showing appropriate deference to non-U.S. regulatory regimes with comparable requirements for entities engaged in swap dealing activities
  - Adopting an approach that permits non-U.S. persons to rely on substituted compliance with respect to swap clearing and trade execution requirements in comparable jurisdictions and apply those requirements in non-comparable jurisdictions with a "direct and significant" effect on the United States
  - Taking a territorial approach to U.S. swaps trading activity, including trades that are "arranged, negotiated, or executed" within the U.S. by personnel or agents of such non-U.S. persons, where non-incidental swaps trading activity in the U.S. should be subject to U.S. swaps trading rules with some activity subject to CFTC rules
- In a speech on October 17, Chairman Giancarlo described his discussions with EU regulatory authorities, in which he asked them to reconsider plans to expand their regulation of counterparty clearinghouses, including U.S. counterparty clearinghouses operating in the EU.

For more information, please visit the FinReg blog – "Chairman Giancarlo's White Paper Outlines Specific Recommendations to Cross-Border Swaps Regulation" (Oct. 12, 2018).

Executive Compensation

- **General Outlook:**
  - The Core Principles suggest that the proposed rules on financial institution incentive compensation, dating from 2016 and involving six agencies, are unlikely to be approved in their final form.
  - In a January 22, 2018 speech, SEC Chairman Clayton stated his belief in taking a "serial approach" to Dodd-Frank mandated executive compensation rules and identified themes to consider in addressing such rules: "true to the statutory mandate, practical, and intended to help companies reduce compliance costs."
  - In a May 21, 2018 meeting attended by SEC Division of Corporation Finance Director Hinman, SEC staff said that they anticipate finalizing the proposed Dodd-Frank hedging disclosure rule by some time in April 2019.
  - On August 15, 2018, Senator Warren introduced the Accountable Capitalism Act, which would prohibit directors and officers of U.S. corporations from cashing out on equity compensation for five years after receiving such compensation, and for three years after a stock buyback, in order to disincentivize corporate use of equity compensation and stock buybacks to increase executive compensation. Prohibited cash-outs would incur a civil penalty.
  - In remarks at a securities regulation conference on November 7, 2018, SEC Commissioner Jackson urged the SEC to finalize Dodd-Frank rules on clawbacks, pay versus performance and hedging disclosure as soon as possible.
  - Post-Dodd-Frank bills have included provisions that would repeal the statutory basis for financial institution incentive compensation, pay ratio and hedging provisions and limit the scope of the clawback and say-on-pay provisions.
- **Changes on the Tax Front:**
  - On August 21, 2018, the IRS issued limited guidance on the Tax Cuts and Jobs Act's elimination of the "performance-based compensation" exception from the Section 162(m) limit on the deductibility of compensation to any covered employee. The guidance clarifies the scope of a "covered employee" and the grandfather for written binding contracts in place on or before November 2, 2017. The IRS's guidance will be incorporated into future Section 162(m) regulations, which will apply to any taxable year ending on or after September 10, 2018.

Regulation Best Interest

- **General Outlook:** As of June 21, 2018, the Department of Labor's fiduciary rule has been vacated in its entirety. The SEC has proposed rules and interpretations (**Regulation Best Interest**), which are open for public comment and seek to enhance the standard of conduct of broker-dealers and investment advisers when they interact with retail investors.
- On September 12, 2018, Congressional Democrats sent a letter to Chairman Clayton urging the SEC to revise Regulation Best Interest "consistent with [Dodd-Frank] and require brokers to abide by the same high standard that currently applies to investment advisers so that their advice to retail investors is provided without regard to their financial and other interests," which the letter states the current version of the proposed rule fails to do.
  - The letter was written by Representatives Waters and Scott and Senators Brown and Murray, and was co-signed by 31 additional Democrats.
- During September 26, 2018 testimony before the House Financial Services Subcommittee on Capital Markets, Securities and Investments, Director Blass, the SEC's Director of the Division of Investment Management, stated that there is no gap between what Dodd-Frank proposed and what the SEC is effectuating with Regulation Best Interest, because the core principles of both are the same.
  - However, the SEC Investor Advisory Committee, as stated in its November 7 meeting, believes the proposal can be strengthened by explicitly characterizing the best interest standard as a fiduciary duty, though it should be made clear that what specific obligations flow from the fiduciary duty will differ according to different business models.
- According to the SEC's updated regulatory agenda, the agency has set a target date of September 2019 to issue a final version of the rule.
  - In addition, the Department of Labor's updated regulatory agenda states that the agency will be issuing a revised version of their fiduciary rule, which was vacated in its entirety by the U.S. 5th Circuit Court of Appeals in *U.S. Chamber of Commerce v. Department of Labor*. The revised rule is also set to be released in September 2019.
  - While agencies have not explicitly stated that they will be working together to harmonize their individual rules, their respective targeted release dates may signal that the SEC and DOL are working together.

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

Regulation Best Interest

- **Regulation Best Interest: Broker-Dealers**
  - Under the proposed regulation, a broker-dealer or associated person would be required to act in the "best interest" of the retail customer at the time the recommendation is made, without placing the financial or other interests of the broker-dealer or associated person ahead of the interest of the retail customer.
  - To meet the best interest standard, broker dealers must also:
    - Establish, maintain, and enforce written policies and procedures reasonably designed to:
      - Identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations
      - Identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations
- **Regulation Best Interest: Investment Advisers**
  - For investment advisers, the proposed regulation seeks to reaffirm, and in some cases clarify, certain aspects of the fiduciary duty that an investment adviser owes to its clients under Section 206 of the Advisers Act in a single release.
  - This release would seek to restate clearly the fundamental elements of an investment adviser's duty of loyalty and duty of care, including duties to provide advice that is:
    - In the client's best interest
    - To seek best execution
    - To act and to provide advice and monitoring over the course of the advisory relationship
    - To put its clients' interests ahead of its own
  - While most, if not all, of the above is familiar, it is notable that the SEC has sought to compile in a single interpretation a wide body of law that is dispersed across numerous rules, court decisions, SEC releases and other guidance.

Cannabis-Related Banking

- **General Outlook:** The direction of the federal regulatory and enforcement framework for financial institutions providing services to U.S. cannabis-related businesses has been uncertain, and providing direct banking services to such businesses has therefore been considered too perilous by most large institutions. While legalization of cannabis remains a distant prospect for a divided Congress in 2019, federal relief for related banking services has been garnering bipartisan support, and the resignation of Attorney General Sessions may make a political or regulatory compromise more possible.
  - As Canada and more states legalize cannabis, including those states approving recent midterm ballot initiatives, even those banks which are avoiding the sector will face increased diligence burdens. The need for legislative relief has been taken up by members of Congress and certain regulatory leaders of both political parties, including Comptroller Otting, who stated in October that “we need to come up with a solution” and he is “hopeful there’s enough momentum in that direction.”
- **The SAFE Acts**
  - Legislative proposals in both the House and Senate targeted at providing clarity to banks have attracted bipartisan support:
    - The Secure and Fair Enforcement Banking Act of 2017 (**House SAFE Act**), most recently introduced by Representative Perlmutter in April 2017, now has 95 cosponsors, including 12 Republicans.
    - The Senate version of the Secure and Fair Enforcement Banking Act (**Senate SAFE Act**) introduced by Senator Merkley in May 2017, and reintroduced, though not successfully, as a proposed amendment to EGRRCPA during Senate consideration in March 2018, now has 20 cosponsors, including four 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

Cannabis-Related Banking

  - 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 SAFE Acts**
  - 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".
- **The STATES Act**
  - In June 2018, Senators Warren and Gardner introduced the bipartisan Strengthening the Tenth Amendment Through Entrusting States Act (**STATES Act**), which would go further than the House and Senate SAFE Acts by clarifying federal law in general with respect to states that have legalized marijuana by providing that the Controlled Substances Act would not apply to marijuana-related conduct that is legal under state law. The STATES Act now has 10 cosponsors, including five Republicans.
  - The STATES Act would also explicitly protect the banking sector by providing that:
    - The proceeds of any marijuana transaction conducted in compliance with state law would not be deemed the proceeds of an unlawful transaction under the Money Laundering Control Act or any other provision of law, and
    - Marijuana-related conduct that is legal under state law would not serve as a basis for criminal or civil asset forfeiture.

For more information on the STATES Act, please visit the FinReg blog – "Bipartisan Marijuana Bill Would Permit Banking Legal Cannabis Businesses" (June 13, 2018).

Fintech Charters

- **General Outlook:** Different views on approach and an intense stakeholder scrum developing. Major developments from Treasury and the OCC were issued in late July.
- **Potential Methods of Change:**
  - **Charter**
    - On July 31, the OCC announced that it would begin accepting applications for special purpose national bank charters from **nondepository** fintech companies engaged in the business of banking.
    - The accompanying licensing manual supplement stated that such special purpose national banks "would engage in one or more of the core banking activities of paying checks or lending money, but would not take deposits and would not be insured by the [FDIC]…Fintech companies that…plan to take insured deposits…should apply for a full-service national bank charter."
    - The release of the OCC's July 31 policy statement and accompanying licensing manual supplement was quickly followed by criticism from the NYDFS and the Conference of State Bank Supervisors (**CSBS**), who had separately previously sued the OCC over its 2016 proposal to issue such charters. Both suits were dismissed as speculative.
      - The NYDFS filed a new suit against the OCC on September 14, which again seeks a declaration that the OCC exceeded its authority under the National Bank Act and violated the U.S. Constitution's 10th Amendment by usurping powers belonging to states. The CSBS also filed a suit against the OCC on October 26, reasserting its previous policy concerns and legal objections.
    - The OCC's Chief Innovation Officer, Beth Knickerbocker, confirmed that the OCC has not received any applications for fintech charters as of October 16, but Comptroller Otting said on October 17 that the OCC would be able to approve or deny charters for fintech companies by the middle of 2019.

For more information on these topics, please visit the FinReg blog – "Treasury Calls for Banking Regulators to Harmonize and Modernize Permissible Activities of Banking Organizations" (Aug. 13, 2018), "Treasury Tailored R&R – New and Important for Fintech Charters" (Aug. 6, 2018) and "Treasury Fintech Report Addresses Wide-Ranging Topics with Reform Recommendations" (July 31, 2018).

Cybersecurity

- **General Outlook:** Cybersecurity is a high-priority item for legislators and regulators at the federal and state levels, as well as internationally.
- **Federal Approaches to Reform**: Both legislative and regulatory

Legislative

- On May 24, 2018, the Senate Banking Committee held a hearing on "Cybersecurity: Risks to Financial Services Industry and Its Preparedness" and Chairman Crapo stated that "[t]he collection and use of [personally identifiable information] will be a major focus of the Banking Committee moving forward…" Likely to return as Committee Chairman, Senator Crapo has stated publicly that "data and privacy issues" would be a particular focus in the next Congress.
- Various legislation to address data security has been introduced, but not yet approved, by Congress.
  - On September 7, 2018, Representative Luetkemeyer introduced a bill that would amend Gramm-Leach-Bliley to provide a national standard for data security and breach notification. The bill was reported favorably out of the House Financial Services Committee, with the vote split on party lines, on September 13, 2018.

Regulatory

- The Federal Reserve's November 2018 Supervision and Regulation Report listed cyber-related risks as a supervisory priority for firms of all sizes.
- In his prepared testimony accompanying the release of the report, Vice Chairman for Supervision Quarles stated that cyber and information technology risks will be monitored closely in the coming year. Cybersecurity is a 2018 supervision and examination priority for the OCC, the FDIC and the SEC as well.
  - 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 October 16, 2018, the SEC released a Section 21(a) report of investigation on whether certain public issuers that were the victims of cyber-related frauds (primarily phishing schemes) violated federal securities laws by failing to have a sufficient system of internal account controls. The report warned that while enforcement was not warranted in the case of these issuers, it may be in the future.
- On February 21, 2018, the SEC released updated interpretive guidance, available here, regarding disclosure of cybersecurity risks and incidents and noting the implications of cybersecurity incidents for insider trading compliance.

For more information on cybersecurity, please visit our Cyber Breach Center.

Cybersecurity

- **State Approaches to Reform:** Primarily legislative
  - As of March 2018, all 50 states now have data security laws with breach notification provisions.
  - The NYDFS cybersecurity regulations (23 NYCRR 500) remains a model for state financial regulators.
- **International Approaches to Reform**: Both legislative and regulatory
  - The Canada Digital Privacy Act became effective on November 1, 2018.
- **Other Potential Methods of Change:**
  - Federal data security and breach notification proposals have been introduced in Congress by both parties over the last few years.
    - Although such proposals were ultimately unsuccessful, Treasury's primary recommendation for data security and breach notification, as stated in the Treasury Fintech Report, is for Congress to pass a federal law governing both.
  - The FSOC 2017 Annual Report recommends that the federal regulators harmonize cybersecurity supervision and regulation and that Congress pass legislation granting examination and enforcement authority to the SEC, CFTC, FHFA, and NCUA to oversee third-party service providers.
  - 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 or create a new, more business friendly law altogether.
- **Trends across state, federal, and international laws and regulation:**
  - Shortened breach notification timelines
  - Incident response preparedness, including an emphasis on training and oversight at the Board level
    - Treasury recently published a tabletop exercise template for small and mid-size financial institutions
  - Data minimization, including disposal of information that is no longer necessary for business purposes

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Appendix A: Executive Order and Treasury Reports

Executive Order and Treasury Reports	
President Trump issued an Executive Order on Core Principles for Regulating the United States Financial System (**Core Principles**).	February 2017
The Treasury Department has published six reports on the conformity of U.S. financial regulations to the Core Principles, all of which are designed to influence financial regulatory reform:	
• *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (**Treasury Banking Report**)	June 2017
• *A Financial System that Creates Economic Opportunities: Capital Markets*	October 2017
• *A Financial System that Creates Economic Opportunities: Asset Management and Insurance*	October 2017
• *Financial Stability Oversight Council Designations* (**Treasury FSOC Report**)	November 2017
• *Orderly Liquidation Authority and Bankruptcy Reform* (**Treasury OLA Report**)	February 2018
• *A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* (**Treasury Fintech Report**)	July 2018

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