May 31, 2018

President Signs Dodd-Frank Reform Legislation

On May 24, following passage in both the House and Senate earlier this year, President Trump signed into law a financial services reform bill relaxing certain elements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). The bill, titled the "Economic Growth, Regulatory Relief, and Consumer Protection Act" (the "Act"), limits the application of various provisions of Dodd-Frank to small and mid-sized banks and raises asset thresholds above which larger banks are subject to increased oversight and regulation. The Act also amends certain other provisions of the federal securities laws. Unlike earlier proposed legislation seeking a comprehensive re-working of Dodd-Frank, such as the Financial CHOICE Act (see our memorandum on the proposed legislation here), the Act preserves the basic structure of Dodd-Frank while making various targeted adjustments.

Among other things, the Act:

- amends the Bank Holding Company Act of 1956 to exempt banks with assets valued at less than $10 billion from the "Volcker Rule," which prohibits insured depository institutions and certain other banking entities from engaging in proprietary trading or entering into certain relationships with hedge funds and private-equity funds;

- raises the threshold for designation of a bank holding company as a Systemically Important Financial Institution ("SIFI") from $50 billion in assets to $250 billion in assets. Banks designated as SIFIs must, among other requirements, adhere to stricter rules and oversight and produce "living wills" describing how they would liquidate their assets in the event of a bankruptcy;

- exempts small and regional banks falling below new, higher asset thresholds from certain requirements for loans, mortgages and trading, and allows them to avoid other federal oversight such as stress tests and leverage ratio requirements;

- increases from $5 million to $10 million the amount of securities that a non-SEC reporting company may issue in any 12-month period pursuant to Rule 701 under the Securities Act of 1933; and

- liberalizes the exemption under 3(c)(1) of the Investment Company Act of 1940 applicable to venture capital funds.

A summary of certain key provisions of the Act is set forth below.

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Volcker Rule Exemption for Smaller Entities

The Act makes two changes to the Volcker Rule. First, the Act exempts from the Volcker Rule insured depository institutions that (i) have $10 billion or less in total consolidated assets; and (ii) have total trading assets and trading liabilities that are less than 5% of total consolidated assets. Second, the Act amends the asset management exemption. Previously, one of the conditions for reliance on the exemption was that the banking entity not share the same name as the hedge fund or private equity fund for marketing or other purposes. Under the Act, a banking entity that is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company and is an investment adviser to a hedge fund or private equity fund is permitted to have the same name as the hedge fund or private equity fund (subject to certain conditions) and still rely on the asset management exemption.

Increased Regulatory Thresholds

- ***SIFI Designation***. Under Section 165 of Dodd-Frank, bank holding companies with at least $50 billion in total consolidated assets are subject to enhanced prudential standards, including, among other things, resolution planning requirements, short term debt limits and contingent capital requirements. The Act increases the threshold for the enhanced prudential standards under Section 165 to $100 billion or less in total consolidated assets. Bank holding companies with total consolidated assets between $100 billion and $250 billion will be exempt from the enhanced prudential standards beginning in November 2019, although the Federal Reserve will be authorized to apply enhanced prudential standards to bank holding companies in this group if it deems appropriate to mitigate risks to the financial stability of the United States or to promote the safety and soundness of the bank holding company. In addition, the Act applies enhanced prudential standards to any institution identified as a global systematically important bank holding company regardless of its actual asset size.

  The Act does not limit the supervisory, regulatory or enforcement authority of the Federal Reserve, the Federal Deposit Insurance Corporation or the Office of the Comptroller of the Currency to further the safe and sound operation of the institutions they supervise. The Act also does not affect the Federal Reserve's enhanced prudential standards as applied to foreign banking organizations with total consolidated assets of $100 billion or more or otherwise limit the authority of the Federal Reserve to (i) require a foreign banking organization with $100 billion or more in total assets to establish a U.S. intermediate holding company, (ii) implement enhanced prudential standards with respect to such organizations, or (iii) tailor regulation for such organizations.

- ***Stress Testing***. The Act relaxes the stress testing requirements for bank holding companies as established by Dodd-Frank.

Supervisory stress tests conducted by the Federal Reserve will no longer be required for bank holding companies with less than $100 billion in total consolidated assets. Beginning in November 2019, bank holding companies with total consolidated assets between $100 billion and $250 billion will be subject to "periodic" stress tests (a term not defined in the Act). Bank holding companies with more than $250 billion in total consolidated assets and nonbank SIFIs remain subject to annual supervisory stress tests.

Company-run stress tests are no longer required for bank holding companies, depository institutions and savings and loan holding companies with total consolidated assets of less than $250 billion. Bank holding companies above that threshold (or a bank holding company with more than $100 billion in assets that the Federal Reserve has deemed subject to enhanced prudential standards) and nonbank SIFIs will still be required to perform company-run stress tests but will be required to do so on a "periodic" rather than annual or semi-annual basis.

Both the supervisory stress test and the company-run stress test need consider only two scenarios (baseline and severely adverse) rather than the previous three (baseline, adverse, and severely adverse). The Act applies both supervisory and company-run stress tests to any institution identified as a global systematically important bank holding company regardless of its actual asset size.

Adjustment to Supervisory Ratio Calculations

The Act adjusts the calculation of certain supervisory ratios. In particular, the Act directs that a custodial bank may exclude funds deposited with a central bank from the custodial bank's total assets for purposes of calculating the custodial bank's supplementary leverage ratio. "Custodial bank" is defined as any depository institution holding company predominately engaged in custody, safekeeping and asset servicing activities, including any insured depository institution subsidiary of such holding company.

The Act also permits banks to include certain investment-grade municipal securities that are liquid and readily marketable as "level 2B" liquid assets for purposes of calculating the bank's liquidity coverage ratio.

Accommodations for Community and Smaller Banks

Banks and bank holding companies that have less than $10 billion in total consolidated assets, meet the definition of "qualifying community bank" and maintain a leverage ratio of at least 8—10% (the final ratio will be set by the federal banking agencies) are exempt from the U.S. risk-based capital rules imposed under Basel III. The federal banking agencies have the discretion to disqualify a bank or bank holding company if they determine that the relief is not appropriate given the bank's or bank holding company's risk profile.

In addition, the Act:

- raises the total asset threshold from $10 billion to $50 billion for the risk committee requirement imposed by Dodd-Frank on publicly traded bank holding companies;
- increases the asset threshold for insured depository institutions to qualify for an 18-month examination cycle from $1 billion to $3 billion;
- permits federal savings associations with total consolidated assets of $20 billion or less to have the same rights, privileges, duties and restrictions as national banks, without converting to a national bank charter;
- requires that federal banking agencies issue regulations to allow for a reduced reporting requirement for a "covered depository institution," defined as an insured depository institution that (i) has less than $5 billion in total consolidated assets; and (ii) satisfies such other criteria as the federal banking agencies deem appropriate;
- raises the asset threshold for the application of the Federal Reserve's Small Bank Holding Company and Savings and Loan Holding Policy Statement from $1 billion to $3 billion, permitting these entities to operate with higher levels of debt than would otherwise be permitted; and
- provides regulatory relief for certain aspects of mortgage lending, especially with respect to such loans made by smaller institutions.

Securities Laws

- ***Equity-based Compensation***. Rule 701 of the Securities Act of 1933 is an exemption from the registration requirements of the securities laws that permits private companies to grant equity awards to employees, directors and consultants without providing financial statements and risk factor disclosures. The Act directs the SEC to revise Rule 701 in order to increase from $5 million to $10 million the amount of equity awards that a company may issue in a 12-month period.
- ***Investment Company Act Section 3(c)(1).*** The Act amends Section 3(c)(1) of the Investment Company Act of 1940 to increase, in the case of "qualifying venture capital funds" (namely, venture capital funds that have not more than $10 million in aggregate capital contributions and uncalled committed capital), the number of investors below which the qualifying venture capital fund would be excluded from the definition of "investment company." That threshold has been raised from 100 to 250 investors.
- ***Algorithmic Trading Study***. The SEC is required to submit to the Senate Committee on Banking, Housing, and Urban Affairs and to the House Committee on Financial Services a report

detailing the risks and benefits of algorithmic trading in United States capital markets within 18 months of the Act's enactment. The report is required to include: (i) an assessment of the effect of algorithmic trading on the provision of liquidity in stressed and normal market conditions; (ii) an analysis of whether the activity of algorithmic trading and the entities that engage in it are subject to appropriate Federal supervision and regulation; and (iii) a recommendation of any changes that need to be made to existing regulations concerning algorithmic trading based on this analysis, and whether the SEC needs additional legal authorities or resources in order to effect such changes.

- ***Regulation A***. The SEC is directed to amend Regulation A, an exemption from the registration requirements of the Securities Act available only to private companies, to make it available to companies that are already public as an alternative method of conducting a public offering.
- ***State Blue Sky Laws***. The Act expands the federal exemption from state Blue Sky laws to cover all securities qualified for trading in the national market system, rather than only those listed on a limited number of specified exchanges.
- ***Closed-End Companies***. The SEC is directed to establish rules generally treating closed-end funds like other public company issuers under certain offering and proxy rules.

Cyber Threat Report

Within one year of enactment, the Secretary of the Treasury is required to submit a report to Congress on the risks of cyber threats to U.S. financial institutions and capital markets. The report must include: (i) an assessment of the material risks of cyber threats, (ii) the impact and potential effects of material cyber attacks, (iii) an analysis of how the federal banking agencies and the SEC are addressing these material risks, and (iv) a recommendation of whether additional legal authorities or resources are needed to adequately assess and address the identified risks.

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The Act's provisions are generally effective immediately with the exception of certain changes applicable to banks with assets between $100 billion and $250 billion and those that require SEC rulemaking as described above.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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