Summary

The Financial Regulatory Improvements Act of 2015

I. Overview

The Senate Banking Committee reported the Financial Regulatory Improvements Act of 2015 (FRIA) on May 21 by a partisan 12-10 vote. During the markup, three amendments were adopted, including a Manager's Amendment by Chairman Shelby and amendments proposed by Senators Toomey (R-PA) and Crapo (R-ID). An amendment by Senator Brown (D-OH) representing the alternative proposed by Democratic members of the Committee was rejected by a party-line 10-12 vote. The amendments adopted make several substantive changes to the Chairman's Mark and these are noted below.

As reported by the Committee, FRIA has eight titles and includes a broad range of regulatory relief and other provisions that amend the Dodd Frank Act (DFA) and several other banking laws.[1] While the overall scope of the bill is broad, the individual provisions – especially with respect to regulatory relief – are fairly targeted and many have received bipartisan support in the Senate and House.

FRIA would provide, to varying degrees, regulatory relief for banks of all sizes, tailor the regulatory structure for systemically important banks and begin the restructuring of the Federal Reserve System and the housing finance system - Fannie Mae and Freddie Mac. The bill does not contain provisions that would increase credit union business lending authority or otherwise provide major benefits to credit unions or the farm credit system.

FRIA's regulatory relief provisions include several measures that are part of ABA's Agenda for America's Hometown Banks, many of which have been introduced as standalone measures or in other relief packages in both houses of Congress. For example:

- Provides a QM safe harbor for mortgages held in portfolio;
- Establishes an Office of Independent Examination Review;
- Reduces the burden of unnecessary privacy notice paperwork;
- Helps rural customers receive CFPB mortgage exemptions;
- Extends the exam cycle for more institutions;
- Requires a study of Basel III's treatment of mortgage servicing assets;
- Requires the regulators to provide short form Call Reports based upon the size and complexity of an insured depository institution; and

[1] The bill is a revised version of the Discussion Draft released May 12.

- Exempts insured depository institutions with less than $10 billion in assets from the "Volcker Rule, unless they are part of a larger holding company or engage in non-traditional banking activities or activities that pose safety and soundness risks.
- Prohibits the bank and credit union regulatory agencies from implementing or participating in Operation Choke Point or any similar program.
- Raises the threshold for CFPB exams from $10 billion to $50 billion in assets.

Importantly, FRIA also contains structural reforms supported by the ABA. It would raise the threshold for automatic designation as a systemically important financial institution (SIFI) from bank holding companies with $50 billion or more in consolidated assets to those with more than $500 billion. Banks having $50 billion to $500 billion in assets could still be designated as SIFIs after evaluation by FSOC and the Fed. Any bank with less than $50 billion in assets would not be a SIFI.

In addition, the threshold for DFA-mandated stress testing would be raised from bank holding companies with more than $10 billion in consolidated assets to those with more than $50 billion in assets. The threshold for the required supervisory stress tests would be raised from $50 billion in assets to apply to institutions with more than $500 billion in assets and those who are otherwise designated as systemically important in the $50 billion to $500 billion range.

The following is a summary of key provisions of FRIA.

II. Regulatory Relief

The bill includes several provisions that the ABA has identified as priorities for regulatory reform.

Privacy Notice Relief

Redundant mailings of annual written privacy policy notices would be eliminated when a financial institution's privacy policy has not changed since the last time it communicated to its customers. Two other conditions apply. To the extent it has shared any customer information with third parties it must have done so in accordance with the exceptions to the notice and opt-out requirements provided in the GLBA. In addition, it must provide customers with access to the most recent privacy disclosure in electronic form or other method permitted by regulations. This is very similar to ABA supported legislation that has repeatedly passed the House and has been re-introduced in the House and Senate this Congress.

Rural Area Designation

The CFPB would be required to establish an application process for a person to apply to have an area designated as a rural area if it has not already been designated as such by the Bureau. This is very similar to ABA supported legislation introduced in the House. Creating special review categories is critical to banks' abilities to meet their community's needs since it would help to assure that whatever definition of rural is ultimately used by the CFPB, there would be a mechanism to apply to the Bureau to extend the definition of rural in those inevitable cases where a county may have been inappropriately excluded.

Independent Examination Review

An Office of Independent Examination Review would be established in the Federal Financial Institutions Examination Council (OCC, FDIC, Fed, NCUA, and CFPB) to review complaints from financial institutions or their representatives concerning examinations and examination reports. The Director of the office would hold meetings with financial institutions, review examination procedures of the FFIEC agencies and conduct a continuing and regular program to ensure examination quality. This provision, while helpful, falls short of ABA advocated legislation introduced in past Congresses that would have required a 60-day turnaround report following a banks examination and the establishment of an independent appeals process for examination decisions.

QM Safe Harbor for Loans Held in Portfolio

Any loan made by a creditor and held in that creditor's portfolio since origination, or a portfolio loan that is later acquired and also held in portfolio, would be treated as if it were a Qualified Mortgage (QM). Certain types of loans would not be eligible, including those containing negative amortization, interest-only, and no documentation loans. This is similar to ABA advocated legislation introduced in the House. Additional language has been added that requires the appropriate Federal banking agencies to periodically review mortgage portfolios of systemically important banks if there is elevated risk, an increase in delinquencies and for other circumstances.

Protecting Consumer Access to Mortgage Credit – Points and Fees

Escrow for future payments of insurance would be excluded from the computation of points and fees in escrow for future payments of insurance for purposes of determining whether a loan meets the QM test. GAO is required to study the impact of the DFA mortgage rules on the availability of credit. This is similar to ABA supported legislation introduced in the House.

<u>18-Month Exam Cycle</u>

The number of depository institutions that would be eligible for the 18-month examination cycle would be increased by raising the current $500 million asset threshold to $1 billion. Similar legislation was incorporated in an ABA initiated regulatory relief bill that has been introduced in the House. Approximately 664 banks could benefit from this change.

<u>Inflation Adjustments for DFA and Other Thresholds</u>

Each of the following DFA thresholds would be adjusted yearly for inflation: $10 billion small bank exception from the Durbin interchange amendment; $10 billion CFPB small bank exam threshold; $10 billion CFTC swaps end-user clearing requirement exception; $10 billion SEC swaps clearing requirement exception; $10 billion FDIC reserve ratio offset threshold; and $1 billion enhanced compensation structure reporting threshold. Over time, these adjustments could have a significant impact on banks that are now, or could be in the future, subject to these thresholds.

<u>Mutual Holding Company Dividend Waivers</u>

This provision is intended to address a current issue for those mutual institutions that have issued minority shares under current Fed rules and help them raise additional capital. Under Regulation MM, the ability to waive paying a dividend to the majority mutual interest held at the holding company level is so onerous that no MHC has been successful in waiving payment. This limits the ability of MHCs to offer minority shares and thereby to raise capital. When the majority mutual interest waives the dividend, the minority interest is paid not only its own dividend, but also a portion that reflects the waived dividend. This gives the minority shareholders a higher return on their investment. The bill directs the Fed to allow dividend waivers, a practice that had been common at the OTS before enactment of the DFA.

<u>Volcker Rule $10 Billion Exception</u>

Insured depository institutions with $10 billion or less in consolidated assets would be exempt from the Volcker rule if they are not controlled by a company with consolidated assets of more than $10 billion. However, the Manager's Amendment added certain conditions. The regulators would have the authority to apply Volcker to banks with $10 billion or less in assets if it determines that the insured depository institution's activities are "inconsistent with traditional banking activities" or due to their nature or volume, pose a risk to the safety and soundness of the institution. The regulators must establish a procedure for notifying an institution when such a decision is made and an opportunity for it to respond.

Study of Capital Requirements on Mortgage Services Assets

The Federal banking and credit union regulators would be required to jointly conduct a study of the appropriate capital requirements for mortgage servicing assets, including the impact of the Basel III requirements on banks and credit unions and their ability to compete. A report must be provided to Congress with any recommendations within 6 months of enactment. Unlike similar ABA supported legislation introduced in the House, there is no requirement for the regulators to stop the further implementation of rules already put in place until the study is completed.

Short Form Call Reports

As provided in the Manager's Amendment, the appropriate Federal banking agencies would be required to jointly review information that is now required to be included in Call Reports and consider the need for the information. After this review, the agencies are to jointly develop, to the extent appropriate, one or more short form Call Reports appropriate for the size and complexity of insured depository institutions. The agencies must report on their progress to Congress every 180 days. (Note that the agencies are already working on "simplified" Call Reports for community banks.)

TILA/RESPA Integration (TRID)

This provision has two distinct elements. First, for HOEPA (high cost) loans only, a mortgage rate can be reduced within 3 days of closing without triggering re-disclosure requirements that would delay closing. Second, a safe harbor is provided for good faith compliance with TRID until the CFPB asserts that TRID requirements are in compliance with all State laws. This helps achieve a "grace period" from aggressive TRID enforcement that ABA is advocating for at the Bureau.

FHLB Membership Proposed Rule

The FHFA has proposed changes to membership eligibility that are overly restrictive. ABA opposes the changes and has asked that the proposal be withdrawn and revised because it contradicts Congress' intent for the FHLBs and would harm the FHLBs, their member banks and the communities they serve. The bill requires FHFA to withdraw the rule and tasks the GAO to study its potential impact. This section of the bill would also provide credit union parity for purposes of FHLB membership (see part IV below).

Require Comprehensive Regulatory Review

The bill adds the CFPB to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) process and DFA regulations are specifically included in the review that must take place at least once every 10 years. Under EGRPRA, the agencies must identify outdated and unnecessary regulatory requirements imposed on financial institutions, solicit input from the private sector, publish the results in the Federal Register, provide an opportunity to comment,

eliminate unnecessary regulations to the extent appropriate and report to Congress on any significant issues raised by public comments and an analysis of whether the agencies are able to address this issues themselves or whether they must be addressed by legislation.

Increase in CFPB Examination Threshold

An amendment by Senator Toomey (R-PA) was added that raises the $10 billion DFA threshold for CFPB exams to $50 billion.

Operation Choke Point

An amendment by Senator Crapo (R-ID) was added that prohibits the FDIC, OCC, Fed, CFPB and the NCUA from implementing or participating in the Department of Justice's Operation Choke Point initiative or any subsequent program or initiative that is similar to that operation.

Savings and Loan Holding Company SEC Registration Threshold

The securities laws would be amended to apply the same registration and deregistration thresholds to SLHCs that are applied to BHCs. This corrects an oversight in the 2012 adoption of the JOBS Act that omitted coverage of SLHCs (the SEC has also initiated proposed rulemaking to address this issue).

III. Important Structural Reforms

The bill includes several titles with various ABA-supported provisions that would provide broad structural reforms to regulation. Several of these provisions would have a major impact on mid-size, regional and other financial institutions if enacted into law.

Systemically Important Bank Holding Companies

The DFA framework currently provides that all BHCs with $50 billion or more in total consolidated assets are automatically deemed systemically important and subject to enhanced regulation. ABA believes that reform in this area is warranted. Title II of the bill changes this so that only BHCs with more than $500 billion in assets are automatically deemed to be SIFIs. BHCs with less than $50 billion in assets are automatically not SIFIs and the Fed's enhanced supervision regime does not apply (although the Fed and other regulators continue to retain general regulatory authority to impose requirements on regulated entities).

For institutions with assets between $50 billion and $500 billion, a process is established for the Fed and FSOC to evaluate individual institutions and determine whether to designate them as SIFIs. Relevant factors include size, interconnectedness, substitutability (whether their services and activities are replaceable in the market), international footprint and complexity. The evaluation process allows input from the BHC, including submission of a plan to change operations to avoid SIFI designation (though there is no explicit commitment to rescind the designation if the plan is approved and the institution executes it). The process is subject to

being overridden in emergencies as determined by FSOC, and the FSOC must review the designations no less frequently than every five years.

This title also conforms the scope of certain enhanced Fed supervision authorities under DFA to the bill's new SIFI designation scheme. Enhanced Fed authority concerning acquisitions, restrictions on large institution management interlocks, company-specific restrictions on activities and products, short-term debt limits, potential contingent capital requirements and requirements for resolution plans would apply based on SIFI status under the new thresholds and FSOC determinations. It also raises the threshold from more than $10 billion in assets to more than $50 billion in assets for requiring internal company stress tests (see below) and risk committees, and potential application of the statutory 15:1 leverage ratio.

Finally, the title conforms the scope of institutions subject to FSOC cost assessments and Fed assessments for enhanced supervision, so that institutions under $500 billion that are not designated as SIFIs no longer have to pay those assessments. In addition, S&L holding companies are no longer subject to this special supervisory assessment.

Stress Tests

Currently, financial institutions with more than $10 billion in consolidated assets are required to perform unnecessary and expensive annual internal "stress tests." This threshold is raised to apply only to institutions with more than $50 billion in assets, and is indexed to inflation. The threshold for the required supervisory stress tests would be raised from $50 billion to apply only to institutions with more than $500 billion in assets or who are otherwise designated as systemically important in the $50 to $500 billion range. It is not clear how this change would impact the current Comprehensive Capital Analysis Review (CCAR) conducted by the Fed on the annual comprehensive capital plans submitted by large BHCs.

Tailored Regulation

The bill provides that it is the Sense of Congress that the financial regulators should seek to properly tailor regulations based upon the capital structure, riskiness, complexity, financial activities, size and other risk factors, using existing authorities, including waiver authorities in law or regulation. ABA has long supported this approach and the introduction of legislation to achieve this goal, and although a Sense of Congress is not a statutory requirement it is a good first step to advancing this issue legislatively.

Nonbank SIFIs

Title III of the bill makes procedural changes for nonbank SIFI determinations that generally track those for BHCs with assets between $50 billion and $500 billion, including required regular reconsideration of their status. It does not change the current factors that FSOC considers in those decisions (which are different from those established for bank holding

companies under the bill), but does make them a non-exclusive list, so that FSOC could add more factors for consideration.

Housing Finance (GSE) Reforms

Title VII starts down the road to comprehensive GSE reform and includes provisions that impact the housing finance market that ABA supports. In general, it limits the ability of the Federal government to spin off GSEs in any form, requires advisory committees, boards of directors, and Congressional support for various GSE reforms that FHFA attempts to put in place. It also accelerates risk sharing by Fannie Mae and Freddie Mac with private investors, which increases the roll of the private capital and reduces taxpayer risk. In addition, the bill:

- Prohibits diversion of GSE guaranty fees for purposes other than those supporting activities of the conservatorships.
- Prohibits transactions in GSE preferred stock unless directed by Congress.
- Requires a formation by FHFA of a secondary market advisory committee to inform policy development.
- Establishes better governance control over a Common Securitization Platform by establishing an independent board and reporting to Congress.
- Requires significant and increasing credit risk sharing transactions, including front-end and first loss transactions between Fannie and Freddie and the private sector each year, shifting risk from the taxpayer to private capital.

IV. Other Issues of Note

The bill contains reforms with respect to several other issues. In some instances, the provisions are under review for potential impact on ABA members. The following is intended as a summary only and not a full description of every provision in FRIA.

Insurance

Title IV of the bill contains provisions that are relevant to the insurance industry, potentially including those affiliated with financial institutions. There are two relatively minor provisions. The first stating that it is the Sense of Congress that McCarran-Ferguson (state regulation) remains the preferred approach to regulating the insurance industry. The second is another Sense of Congress provision that states that the Fed, FDIC and state insurance regulators should develop consensus positions on international capital standards. However, it also creates an advisory committee on insurance matters within the Fed.

Source of Strength. The most substantive provisions are in section 402, which essentially provides a means to wall-off insurance assets from source of strength contributions to failing savings and loans affiliated with insurance companies. Any shortfall caused by the failure of the savings and loan would then fall to the FDIC. Specifically, the Fed must notify a state insurance authority if it seeks to have insurance companies affiliated with an SLHC provide funds to stabilize the SLHC. GLBA included a similar provision for banks affiliated with insurance companies so this provision provides equivalent treatment for SLHCs. Note that under current law, the Fed cannot force the insurance affiliate to provide funds if the state regulator objects, but it could force a divestiture. If adopted this provision would also apply to SLHCs.

FDIC Liquidation Authority. Another provision in section 402 deals with the FDIC's liquidation authority for the resolution of insurance companies. Currently state law controls this, unless the state authorities do not act within 60 days and then the FDIC can step in and file for liquidation. The bill would make it clear that the FDIC's authority applies not only to liquidation but also to "rehabilitation" which is the insurance equivalent of conservatorship. This section makes one further change that may narrow the authority of the FDIC to place a lien on a financial institution in receivership. The bill provides that in the case of an insurance company the FDIC can only place a lien if it is to secure repayment of funds made available to the company and if it consults with the state insurance authority and determines that the lien will not impede the company's liquidation or rehabilitation.

Credit Union Provisions

The bill contains three credit union specific provisions.

Privately Insured Parity for FHLB Membership. There are approximately 200 state chartered credit unions that do not accept NCUA insurance and insure deposits through private insurance, which makes them ineligible for FHLB membership under current law. Section 102 amends current law to make privately insured credit unions eligible for FHLB membership. Legislation similar to this has passed repeatedly in the House.

FHLB Membership. By statute, to become members of FHLBs, financial institutions must meet two tests: 1% of assets directed to "home mortgage loans" (duration of 5+ years) and 10% of assets directed to "residential mortgage loans" (any duration). The FHLB Act exempts from the "10 percent" requirement any "community financial institution" or "CFI," as defined as FDIC-insured banks with less than $1 billion in average total assets (adjusted annually for inflation) over the preceding three years. Because credit unions do not have FDIC insurance, they are not eligible for the CFI exemption. Section 124(b) would amend current law to allow credit unions to be considered CFIs under the same asset levels as banks.

NCUA Budget Transparency. To address views that NCUA's budget has grown too large and unaccountable, NCUA would be required to hold a hearing and receive comments on its budget. Similar legislation is pending in the Senate and House.

Changes to the Federal Reserve System

Title V of the bill contains various changes to how the Fed currently operates. Perhaps the most significant from the banking industry perspective is a requirement that the President of the New York Fed be appointed by the President and confirmed by the Senate. Another provision shifts authority for setting the rate of interest on bank reserves held by the Fed to the FOMC.

Other changes have to do with increasing the frequency of reports to Congress on monetary policy with more detailed analysis, reducing the time lag for FOMC transcript release from 5 to 3 years, establishing an independent commission to recommend restructuring of the Federal Reserve System, a GAO study on regulation to best address systemic risk, and a Fed study on nonbank supervision.

Financial Markets Provisions

Title VI of the bill contains provisions dealing with a variety of financial markets issues.

Repeal of required SEC and CFTC indemnification. As a condition of obtaining access to swap data repositories, the DFA required foreign regulators to indemnify repositories and the CFTC and SEC for any litigation expenses that may arise from sharing information. This requirement would be removed by the language in section 603. According to a joint CFTC-SEC report, international entities objected to the indemnification requirement and were unwilling to register or recognize swap data repositories without access to data.

Compensation plan disclosures. Section 604 requires the SEC to revise regulations requiring an issuer to furnish investors with additional specified disclosures regarding compensatory benefit plans if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $10 million (currently $5 million). This is indexed for inflation every five years.

JOBS Act threshold revisions (emerging growth companies). Currently, Emerging Growth Companies (EGC), which are small, new companies, measured initially by revenue and later by outstanding publicly held securities, can submit their securities filings for confidential review by the SEC staff. In contrast most registrants' filings are public. When companies outgrow EGC status, their initial filings have to be public like other issuers. Section 604 would clarify that an issuer that was an EGC at the time it filed a confidential registration statement for review, but is no longer an EGC, would continue to be treated as an EGC through the earlier of the date on which the issuer consummates its initial public offering pursuant to such registration statement, or the end of the one-year period beginning on the date that the company is no longer an EGC.

Miscellaneous

Section 123 changes the date consolidated assets are measured for purposes of the DFA TruPS grandfather. DFA provides the grandfather for banks below $15 billion in assets as of December 31, 2009. The bill adds "or March 31, 2010." This would have the effect of allowing a bank that was over the threshold on December 31, 2009, but was under the threshold on March 31, 2010, to be covered by the grandfather.