The Financial CHOICE Act (H.R.10) Analysis

The following is an analysis of key provisions of the Financial CHOICE Act (H.R. 10, the “FCA”) important to ABA member banks, as passed by the House by a nearly party-line vote 233-186¹ on June 8, 2017. The House adopted a Substitute Amendment to H.R. 10 that made several changes to the bill as reported by the House Financial Services Committee on May 4 by a party-line 34-26 vote. The House also adopted six other amendments. These changes are incorporated in the following analysis.

A. Election to Maintain High Levels of Capital

The FCA is intended to revitalize economic growth through “competitive, transparent and innovative capital markets.” While the measure makes several regulatory reform changes, a key component and much discussed provision of the bill would be to provide an “off-ramp” from the Dodd-Frank Act’s (“DFA”) supervisory structure and the Basel III capital and liquidity standards for banks that choose to maintain high levels of capital.

The provision contained in Title VI provides that financial institutions (including insured depository institutions and their holding companies) that attain and maintain a leverage ratio of at least 10 percent (see below for calculation method) may elect to be exempted from a number of regulatory requirements, including the Basel III capital and liquidity standards and the “heightened prudential standards” applicable to larger institutions under section 165 of the DFA. Specifically, a bank of any size that makes this election (a “qualifying banking organization” or “QBO”) would not be subject to laws, rules or regulations that:

- Address capital and liquidity requirements, including Basel requirements.
- Permit banking agencies (Fed, FDIC, NCUA, OCC) to block capital distributions to shareholders;
- Permit banking agencies to consider systemic risk when considering an application to consummate a transaction or commence an activity (the 10 percent leverage ratio must be maintained); and
- Permit banking agencies to block or limit mergers, consolidations, or acquisitions of assets or control to the extent they relate to capital or liquidity standards or concentrations of deposits or assets (the surviving entity must maintain the 10 percent leverage ratio).
- Implement the enhanced supervision provisions of Section 165 of the DFA relating to contingent capital, resolution plans, concentration, short term debt limits, risk committees, stress tests and leverage capital.

¹ One Republican voted against the bill.
Traditional and Non-Traditional Banks

The FCA divides the industry into two groups with respect to how the leverage ratio is calculated: traditional banks and non-traditional banks. Traditional banks are defined to include banks that: 1) have zero trading assets and liabilities; 2) do not engage in swaps or security-based swaps, other than those referencing interest rates or foreign exchange swaps; and 3) have a total notional exposure of swaps and security-based swaps of not more than $8 billion. Traditional banking organizations would be eligible to opt for relief if they had at least a 10% GAAP based leverage ratio. This standard would significantly reduce the compliance complexity associated with this title for some institutions.

All banks that do not meet the traditional bank definition would be deemed non-traditional banks. Non-traditional banks would be eligible to opt for relief only if they had at least a 10% supplemental leverage ratio. The supplemental leverage capital ratio is complicated, and assigns risks to both on-balance-sheet assets (by assuming each asset has the same risk as any other) and off-balance-sheet assets (by establishing credit conversion factors – basically exposure measures for each off-balance-sheet asset).

New Banking Organizations

A de novo banking organization, or an entity that becomes a banking organization because it controls a newly chartered insured institution would be treated as a QBO immediately if:

- An election to be treated as a QBO was included in the application; and
- On the date it becomes a QBO the institution’s tangible equity divided by its leverage exposure is at least 10%.

Analysis

The restrictive definition of traditional banking organizations combined with the rigidity of the supplemental leverage ratio raises questions about whether the traditional/non-traditional bank dichotomy unnecessarily limits regulatory relief to hundreds of well-run banks of all sizes, including many community and mid-size institutions. The use of simple litmus tests for qualifying for relief could fail to fully incorporate the use of many safe and legitimate risk management tools that allow banks to better serve their customers and communities.

The overall impacts of this aspect of the FCA are not clear. Many banks would likely choose not to opt for the regulatory relief unless they are substantially above the 10% threshold. For example, banks may only be comfortable making the election if they have a 2% buffer over the

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2 Although the leverage ratio is based on GAAP, it also includes various regulatory deductions (e.g., Basel III deduction of mortgage servicing assets).
10% threshold. Only 28% of banks that are likely to be considered “traditional” banks meet a combined (buffer and base) 12% threshold.

Regardless of category, institutions with greater than $50 billion in assets that make the 10% election would still be subject to the following:

- With respect to Section 165 of DFA, regulatory authority is retained for the Fed to impose more stringent, tailored prudential standards on BHCs with more than $50 billion in consolidated assets.
- The Fed would still be able to require off-balance sheet activities to be reflected in capital calculations, as well as enhanced public disclosures by non-bank financial companies it supervises and BHCs with $50 billion or more in assets, in order to support market evaluation of their risk profile, capital adequacy, and risk management capabilities.

Penalties for Falling Below 10% Standard

There are significant consequences for failing maintain the 10% ratio. A banking organization that has made the election and fails to maintain the 10% ratio will be:

- Prohibited from making a capital distribution if its primary federal regulator objects;
- Required to submit a capital restoration plan to its primary federal regulator and any applicable state regulator within three months after the date it falls below the 10% level; and
- Required to restore its ratio to at least 10% within one year of falling below that level.

If it does not restore the 10% level, it will lose all regulatory relief. In addition, if the organization fails to maintain a 6% leverage ratio, it immediately loses all regulatory relief. An organization that loses regulatory relief but subsequently restores the 10% ratio for at least eight consecutive quarters would be allowed to make a subsequent qualifying election.

B. Regulatory Relief

Title V incorporates several regulatory relief bills supported by the ABA that were either reported by the Financial Services Committee or passed by the House last Congress, and several have been reintroduced this Congress. These provisions are not tied in any way to a specific capital ratio.

TAILOR Act

Section 546 would require the financial regulators to properly tailor regulations based upon an institution’s business model and risk profile to limit regulatory impact, costs, liability risk and

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3 The TAILOR Act (H.R. 1116).
other burdens. ABA worked closely with the State Associations on building support for this legislation.

QM Safe Harbor for Loans Held in Portfolio

Section 516\(^4\) would provide that any loan made by a depository institution and held in 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). There is also a rule of construction providing that a “balloon” payment could also qualify for the safe harbor. This is a priority issue for ABA members, particularly smaller mortgage lenders operating in rural areas.

Protecting Consumer Access to Mortgage Credit – Points and Fees

Section 506\(^5\) would change the way points and fees are calculated for purposes of complying with the CFPB’s Ability-to-Repay/QM rule. 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.

Federal Savings Associations

Section 551\(^6\) would provide greater flexibility to both mutual and stock thrift institutions chartered under the Home Owners Loan Act (HOLA). They would have the ability to exercise national bank powers without changing their charters, while relieving institutions who take the election of the regulatory compliance burdens of the existing Qualified Thrift Lender (QTL) test. This section implements a proposal originated by the Comptroller of the Currency and strongly supported by the ABA.

Small Bank Holding Company Policy Statement

Section 526\(^7\) would apply the Fed’s threshold for application of the Small Bank Holding Company Statement to institutions with less than $10 billion in consolidated assets. The Statement currently applies to institutions with less than $1 billion in consolidated assets; this would permit more small BHCs to use debt to finance acquisitions.

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\(^4\) The Portfolio Lending and Mortgage Access Act (H.R. 2226).

\(^5\) The Mortgage Choice Act (H.R. 1153).

\(^6\) The Federal Savings Association Charter Flexibility Act (H.R. 1426/S. 567).

\(^7\) The Small Banking Holding Company Relief Act (H.R. 1948).
Small Business Loan Data

Section 561 repeals DFA section 1071 that requires the CFPB to collect and report data on small business lending.

Mortgage Escrow

Section 531 would create a safe harbor from mortgage escrow requirements for smaller financial institutions ($10 billion or less in consolidated assets) that hold loans in portfolio for three years. The CFPB would be required to provide exemptions to, or adjustments for, entities that service 20,000 or fewer loans annually from certain escrow requirements to reduce regulatory burdens while protecting consumers.

High-Cost Mortgages

Section 502 would make changes to the definition of “high-cost mortgage”, including increasing the threshold from 8.5 points to 10 points and increasing the value of the transaction from $50,000 to $75,000. The definition and threshold changes to the high cost designation will make it possible for more lenders to better meet the borrowing demands for relatively low dollar loans to higher risk, but still creditworthy borrowers.

Prohibition on “Choke Point”

Section 511 would prohibit a federal banking agency (Fed, OCC, FDIC, NCUA) from formally or informally ordering a depository institution to terminate a customer’s account or restrict or discourage it from entering into or maintaining a banking relationship with a specific customer or group of customers, unless: (1) the agency has a material reason to do so, and (2) the reason is not based solely on reputation risk.

Independent Examination Review

Section 536 would require a 60-day turnaround for final reports following examinations and provides clarity and consistency regarding how the regulatory agencies and their examiners treat commercial loans with respect to nonacrrual, appraisal, classification, and capital issues. It would also establish an independent appeals process for examination decisions.

It would create an Office of Independent Examination Review at the Federal Financial Institutions Examination Council (FFIEC) to review complaints from financial institutions or their representatives concerning examinations and examination reports. The Director of the

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8 The Community Financial Institution Mortgage Relief Act (H.R. 1529, 114th Congress).
9 The Financial Institution Customer Protection Act (H.R. 2706).
10 The Financial Institutions Examination and Fairness and Reform Act (H.R. 1941, 114th Congress).
11 FFIEC consists of representatives of the OCC, FDIC, Fed, NCUA and CFPB.
office would hold meetings with financial institutions, review examination procedures of the FFIEC agencies, conduct a continuing and regular program to ensure examination quality, and report annually to Congress on its reviews, recommendations for improvements in exam procedures and practices, and the timeliness of exam reports.

**Short Form Call Reports**

Section 566\(^x\) would permit highly rated and well capitalized depository institutions to file a short form call report in the first and third quarters of each year, rather than for all four quarters.

**HMDA Reporting**

Section 576\(^y\) would exempt depository institutions that originate less than 100 closed-end mortgages and less than 200 open-end lines of credit each year from the Home Mortgage Disclosure Act’s reporting and record keeping requirements.

**Privacy Risk Study**

Section 571 requires the US Comptroller General is to study and report to Congress about privacy risks presented by HMDA data collections. In addition, depository institutions are not required to “publish, disclose, or otherwise make available” HMDA data elements added by the Dodd-Frank Act or the CFPB’s final HMDA rule, and neither the CFPB nor the FFIEC can publish or disclose the information. All HMDA data reporting required by the CFPB’s new rule is suspended until January 1, 2019.

**Madden Reversed**

Section 581 FCA provides that a loan that is valid when made as to its maximum rate of interest shall remain valid if the loan is subsequently sold, assigned or transferred. This provision effectively reverses the decision of the Second Circuit in *Madden v. Midland*.

**Mutual Holding Company Dividends**

Section 596, which was adopted on the House floor through an amendment by Rep. Faso (R-NY), would reinstate the pre-DFA regulatory treatment of Mutual Holding Companies (MHCs) with respect to minority shareholders by allowing them to pay market rate dividends. This would place MHCs on a more level playing field with stock holding companies and provide

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\(^x\) The Community Bank Reporting Relief Act (H.R. 4500, 114th Congress).

\(^y\) The Home Mortgage Disclosure Adjustment Act (H.R. 2954). As reintroduced in the 115th Congress, this bill expands HMDA relief in this section of the FCA to firms that originate less than 1,000 close-end mortgage loans and less than 2,000 open-end lines of credit.
them the ability to raise additional capital to meet the lending needs of their customers and communities without placing their mutual structure at risk.

C. CFPB Reforms

Title VII of the FCA includes numerous reforms of the DFA’s provisions creating the CFPB, including the structure of the agency, its governance, funding and powers.

Governance and Funding

- CFPB would be renamed the “Consumer Law Enforcement Agency” (“CLEA” or “Agency”) and restructured as an executive agency outside the Fed.¹⁴
- It would be led by a single Director removable at will by the President. In addition, the Deputy Director would be appointed by the President and removable at will.
- The funding would come from Congressional appropriations and not the Fed.

Authority

The scope of the authority provided by the DFA to the CFPB has been a long-standing concern. Several unique CFPB powers created by the DFA would be modified or repealed, including:

- Its mission would be changed from DFA’s sole mandate to oversee and enforce consumer protection laws to a dual mandate of (1) implementing, and where applicable, enforcing consumer laws consistently “for the purpose of strengthening participation in markets” without government interference; and (2) to “increase competition and enhance consumer choice.”
- An Office of Economics, which reports directly to the Director, would be established to review rulemaking and enforcement to assess their impact on consumer choice, price, and access to credit products. The Office would also be required to review proposed and existing rules including regulatory guidance.
- The agency would be required to consider safety-and-soundness issues when promulgating new rules.
- The CFPB’s supervisory authority would be eliminated, limiting the agency to an enforcement agency.
- Authority to prohibit arbitration clauses in financial contracts would be eliminated.
- Authority to regulate small dollar loans would be eliminated.
- The consumer complaints database would be abolished.
- The indirect auto lending guidance would be repealed.
- The Director would be required to establish a procedure to provide advisory opinions.

¹⁴ To avoid confusion we continue to refer to the agency as the CFPB throughout this paper.
DFA mandated offices of Fair Lending and Equal Opportunity, Financial Education, Servicemember Affairs, Financial Protection for Older Americans would be optional. The Consumer Advisory Board would be at the Director’s discretion.

To better protect privacy, the agency would be required to obtain permission from consumers before collecting personally identifiable information.

**Enforcement**

There have been concerns about the CFPB’s focus on enforcement and the scope of its activities in this area. The FCA makes several modifications to address this problem:

- The agency would be authorized to enforce only the enumerated consumer protection laws; it has no UDAAP authority of any kind. The Federal banking regulators would be authorized to enforce and to write rules to prevent unfair or deceptive practices by depository institutions.

- To the extent the CFPB and another federal regulator have enforcement authority with respect to a consumer financial law, the CFPB would have “primary enforcement authority” for insured depository institutions and credit unions with total assets of greater than $10 billion.  

- Segregated accounts would be created for civil money penalties to make better use of the funds to compensate victims and to avoid the creation of surpluses permanently held by the agency.

- The agency’s market monitoring function would be eliminated.

- Defendants in administrative actions would have the right to remove the case to federal court.

- There is a three-year statute of limitations on the agency’s actions.

- Motions to set aside civil investigative demands (CIDs) could be filed in federal courts and reasonable timelines would be mandated for CID recipients to meet with investigators.

- DFA required courts to defer to the agency’s interpretations of the DFA when they conflict with the statutory interpretations of other agencies. This would be repealed, beginning two years after enactment of this provision, courts would review CFPB actions and decide *de novo* all questions of law, including the interpretation of constitutional statutory provisions.

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15 The Rules Committee Substitute added this modification to Sec. 727. Other Federal agencies may recommend that the CFPB initiate an enforcement action against a financial institution and, if the CFPB declines to take action, the other agency could initiate its own enforcement action against the institution.
D. **Other DFA Reforms**

**Volcker Rule Repealed**

Section 901 would repeal the “Volcker Rule.”\(^{16}\) This would remove an exceedingly complex, costly, and burdensome rule, while enabling banks and their affiliates to provide capital generation for businesses of all sizes, manage and advise on institutional investments and corporate investment vehicles, and facilitate liquid markets through enhanced market-making, underwriting, and asset liability and management services. The repeal would allow banks to engage in traditional, routine, and prudent lending, asset management, risk-mitigating hedging, and market-making activities without fear of triggering a Volcker Rule-prohibited trading or investment activity.

**Directed Rulemaking Repeals**

The Substitute Amendment added a new Sec. 2 that provides that rules promulgated under provisions of law repealed by H.R. 10 are no longer in effect.

**Changes to Stress Testing and Living Wills**

The FCA would establish additional standards for process and transparency in the agencies’ conduct of stress testing and living wills. These changes could afford members greater certainty in regulatory expectations as well as consistency in application of these regulatory requirements.

For stress tests, these changes include:

- Extending the Comprehensive Capital Analysis and Review (CCAR) cycle to every two years;
- Eliminating the mid-year company run stress tests;
- Expanding relief from the qualitative aspects of CCAR; and,
- Establishing a notice and comment process for the development of scenarios.

For “living wills”, Section 165 of the DFA is modified:

- A living will can be requested only once every two years;
- Feedback must be provided on the wills to banking organizations within six months of submission; and
- The agencies must publicly disclose their assessment framework.

\(^{16}\) Section 619 of the DFA.
E. “Too Big to Fail”

Title I of the FCA makes several specific changes to the DFA and other laws intended to end Too Big to Fail, including:

- The authority of the Financial Stability Oversight Council (FSOC) to designate nonbank firms as systematically important financial institutions (SIFIs) -- and thereby subject them to enhanced regulatory oversight-- would be repealed on a retroactive basis.
- Title II of the DFA provides for the “Orderly Liquidation” of a failing financial institution by the FDIC. This would be repealed and replaced by a new chapter of the Bankruptcy Code specifically dealing with financial bankruptcies. This provision incorporates The Financial Institution Bankruptcy Act (H.R. 1667) which has passed the House.
- The Exchange Stabilization Fund would be prohibited from bailing out a financial firm or its creditors. As noted by the Committee, in the fall of 2008, the Treasury Department used the Exchange Stabilization Fund, which was established in 1934 to buy and sell foreign currency to stabilize the value of the dollar relative to other currencies, to protect investors in money-market mutual funds. Although Treasury is now barred from using it to protect investors in mutual funds, the FCA would prevent it from being used in other ways for similar purposes.
- The Fed’s emergency lending powers under Section 13(3) of the Federal Reserve Act, already limited under the DFA, would be further restricted. For example, the collateral for emergency lending would be subject to restrictive valuation requirements and a regulatory determination of borrower solvency would be a precondition to funding.
- The FSOC’s authority to designate certain payments and clearing organizations as systemically important “financial market utilities” (FMU) with access to the Fed’s discount window would be repealed. Previous FMU designations would be retroactively repealed.

ABA’s longstanding view has been that no bank is or should be too big to fail. It is worthwhile noting that implementing the reforms to the bankruptcy code do not require DFA Title II, since Title II is triggered only where bankruptcy is not employed. That leaves the question for further careful consideration as to whether repealing Title II of DFA in its entirety eliminates some necessary tools for managing financial stability.

Also, some have expressed concerns with the proposed elimination of the DFA’s Orderly Liquidation Fund (intended to provide liquidity during a resolution handled by FDIC). For example, eliminating Title II and replacing it with a bankruptcy as the only way to resolve a failing institution would leave out any consideration of financial stability concerns for the overall economy in the handling of the bankruptcy case. In addition, there are concerns that elimination of FSOC’s SIFI designation authority for nonbanks could “unlevel” the competitive playing field.
between large banks and large “shadow” nonbanks by removing nonbanks from the DFA enhanced supervision and prudential standards administered by the Fed.

F. Operational Risk

Relevant to larger banks subject to the Advanced Approaches Capital Framework, Section 152 forbids the banking agencies from adopting an operational risk capital charge for business lines or products that a banking organization no longer offers, and requires any operational risk capital requirement to permit adjustments for operational risk mitigants.

G. Judicial Deference Ended

In its 1984 Chevron decision the Supreme Court held that courts should defer to agency interpretations of the law unless they are unreasonable.17 Section 341 of the FCA would repeal Chevron deference with respect to the financial regulatory agencies18 by altering the standard of judicial review in the Administrative Procedure Act (APA) effective two years after enactment. Specifically, the courts are required to decide a case “de novo” and without deference to the agency’s interpretation of the law. The courts are also required not to interpret any “gap or ambiguity” in a statute as an “implicit delegation” of rulemaking authority to the agency. Section 341 provides that--

[T]he reviewing court shall determine the meaning or applicability of the terms of an agency action and decide de novo all relevant questions of law, including the interpretation of constitutional and statutory provisions, and rules made by an agency. If the reviewing court determines that a statutory or regulatory provision relevant to its decision contains a gap or ambiguity, the court shall not interpret that gap or ambiguity as an implicit delegation to the agency of legislative rule making authority . . .

Chevron essentially gives an agency deference based upon its expertise which can be particularly important in light of the often complicated and technical aspects of financial services law and regulation. For example, deference accorded to the OCC has helped to protect the preemptive aspects of the national bank charter. It also played a key role in the Fed’s interpretation of the Durbin amendment. However, in some situations deference can be harmful, especially where an

17 JUSTICE STEVENS delivered the opinion of the Court. “First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute . . . Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.” Chevron U.S.A. v. NRDC, 467 U.S. 837, 842-43 (1984).

18 The Fed, FDIC, OCC, NCUA, SEC, CFTC and FHFA. Note section 718 removes the “Heightened” deference accorded to the CFPB by the DFA.
agency acts without fully understanding or taking into consideration the adverse impact of a rule on consumers and the financial industry. It may also facilitate the NCUA’s attempts to expand credit union powers and membership. For these reasons, the ABA has questions about the impact of repealing *Chevron* that require further study.

**H. Supervisory Reforms**

**Rulemaking Changes**

**Congressional Approval of Major Rules:** Title III incorporates legislation making significant changes to the rulemaking process. It would require Congress to approve “major rules” by the financial regulators\(^{19}\) before they can go into effect.\(^{20}\) This would replace current law which merely allows Congress to disapprove a major rule. The Congressional approval process would specifically not apply to rules concerning monetary policy that are proposed or implemented by the Fed or the Federal Open Markets Committee.\(^{21}\)

A rule is considered a “major rule” if it would likely result in an annual economic impact of more than $100 million, result in major price increases for consumers or costs to businesses, or have significant adverse effects on competition, employment, investment, productivity, innovation or international competitiveness. The Office of Information and Regulatory Affairs (OIRA) at OMB makes this determination.

**Cost-Benefit Analysis Required:** Title III would also require the financial regulatory agencies\(^{22}\) to conduct a detailed cost-benefit analysis of proposed rules. Specifically, an agency may not issue a notice of proposed rulemaking (NPR) unless the notice includes an assessment of the need for the rule and a cost-benefit analysis of its quantitative and qualitative impacts. Regulators must allow at least 90 days for notice and comment on a proposed rule and publicly release the data underlying their analyses. If the costs of the rule are determined to outweigh its benefits, the regulators will be prohibited from finalizing the rule absent an express authorization from Congress. They would also be required to perform retrospective review of those rules every five years, using a pre-defined set of metrics, to evaluate their success or failure.

**International Negotiation Disclosures Required:** The Financial regulators would be required to release for public notice and comment of any positions they plan to take as part of international regulatory negotiations. They must report to Congress on the negotiations at their conclusion.

These provisions are intended to provide more transparency and accountability in the rulemaking process, especially with respect to policy developed overseas to which U.S. regulators commit.

\(^{19}\) Fed (non-monetary policy), FDIC, OCC, NCUA, SEC, CFPB, CFTC, FHFA.

\(^{20}\) The REINS Act (H.R. 26). Passed House.

\(^{21}\) Section 338.

\(^{22}\) The Fed, FDIC, OCC, NCUA, SEC, CFPB, CFTC, FHFA.
before consulting industry and the public in the United States. Typically, the public is formally made aware of such projects relatively late in the process, after the basic framework has been substantially developed, options have been narrowed, compromises have been made, and a strong degree of international commitment to a new regulatory regime has been reached by the regulatory participants. Earlier consultation in the U.S. would permit the public and industry and other policymakers to be more informed and able to raise important matters of concern. At the same time, U.S. agency representatives participating in the international discussions will themselves gain valuable information and insights and be able to speak from a stronger base of information and understanding of the impact on the people whom they represent at the negotiating table.

**Changes in Supervisory Enforcement**

The FCA requires financial agencies to implement policies to better coordinate enforcement actions by implementing policies to minimize duplication between federal and state authorities, determining when joint investigations and enforcement actions are appropriate, and if so, establishing a lead agency.\(^{23}\) It also would prohibit a financial agency, and the DOJ, HUD and the Rural Housing Service of the Department of Agriculture from agreeing to any settlement that would provide payment to a person not a victim of the alleged wrongdoing.\(^{24}\)

**Changes in Agency Structure and Funding**

**Revise FDIC Board:** Section 351 modifies the FDIC’s board by replacing the CFPB director and the OCC with two independent members. All five members of the Board would now be appointed by the President.

**FHFA:** The governing structure remains the same except that section 352 would make the Director removable at the will of the President.

**Unfunded Mandates:** The federal financial regulatory agencies would be required to issue statements providing estimates for the compliance costs of federal mandates on particular regions of the nation, states, tribal and local governments, particular communities before promulgating notices of proposed rulemaking or final rules.

**Appropriations:** Funding for the FDIC, FHFA, NCUA, and OCC would be subject to the annual appropriations process.\(^{25}\) With respect to the Fed, its regulatory and supervisory activities would be subject to appropriations but its monetary policy functions would not.

Although Congressional oversight of the agencies is appropriate, there could be unintended consequences that should be explored. For example, would there be an impact on the costs of

\(^{23}\) Section 391. Includes the Fed, CFPB, CFTC, FDIC, FHFA, OCC, NCUA, and SEC.

\(^{24}\) Section 393.

\(^{25}\) Title III, Subtitle E.
examinations and other fees and expenses, and could it potentially slow-down needed agency actions?

**Independent Insurance Advocate:** Title XI would create the Office of Independent Insurance Advocate within Treasury which would be a voting of FSOC and would replace the Federal Insurance Office.

**Federal Reserve Reform Provisions**

The FCA incorporates provisions included in separate House legislation, the Fed Oversight Reform and Modernization (FORM) Act (H.R. 3189, 114th Congress). These are intended to provide greater transparency and accountability in the Fed’s conduct of monetary policy and prudential regulation:

- The Federal Open Market Committee (FOMC) would be required to describe how its policy rate decisions compare to a well-known standard.
- A more balanced rotation of the Fed’s twelve District Bank Presidents, who vote during each FOMC meeting, would be required.
- The Chairman of the Board of Governors would be required to testify before the House Financial Services and Senate Banking Committee on a quarterly rather than a semi-annual basis.
- The Board’s Vice Chair would be required to testify before Congress on supervisory matters on a semi-annual basis in instances where the Board does not have a Senate-confirmed Vice-Chair for Supervision (which was required by the DFA).
- An annual audit of the Board and Federal Reserve Banks would be performed by GAO.

I. **Capital Markets and Capital Formation**

Titles IV and VIII of the FCA include a variety of provisions, including previously-introduced House bills, intended to improve the capital markets and to facilitate capital formation to assist small businesses, innovators and the creation of jobs. Key provisions impacting ABA members are summarized below.

**Department of Labor Fiduciary Rule and SEC Standard of Care for Broker Dealers**

Section 841 would repeal the Department of Labor’s Fiduciary Rule, eliminating a burdensome and costly regulation on the retirement services industry. Further, DOL cannot prescribe any new fiduciary rule until after the SEC issues a final fiduciary rule for broker-dealers.

This section also would prohibit the SEC from promulgating a rule on standards of conduct for brokers and dealers before it provides reports to the House Financial Services Committee and the

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26 Title X.
Senate Banking Committee describing whether retail investors are being harmed due to brokers or dealers operating under different standards of conduct and on several other related issues. Along with the rule, the SEC would be required to publish its formal findings regarding how the rule would reduce confusion or harm to retail customers.

Risk Retention – Nonresidential Mortgages

Section 842 would exempt from DFA risk retention requirements all asset backed securities except residential mortgage-backed securities. RMBS, with its “originate to distribute” process, accounted for by far the largest number of defaults during the financial crisis. This provision will provide needed relief for other classes of asset-backed securities which already have “skin in the game” as part of their origination processes.

Small Issuer Exemption from Internal Control Evaluation

The DFA made permanent the exemption for non-accelerated filers to comply with an outside auditor’s attestation of a company’s internal financial controls mandated by Section 404(b) of the Sarbanes-Oxley Act. However, the threshold of $75 million in market capitalization still captures thousands of small companies, including banks. Section 847 would increase the exemption to issuers with a market capitalization of up to $500 million and extends the exemption to depository institutions with less than $1 billion in assets.

Executive Compensation

Various provisions of Title VIII would revise or repeal sections of the DFA to return to Boards of Directors control over setting compensation programs for executives:

- Section 843 would revise DFA section 951 to require a shareholder vote on executive compensation only if there has been a material change.
- Section 849 would limit the application of DFA section 954 imposing “clawbacks” of compensation in the case of certain financial restatements to current or former executives who had control or authority over financial reporting.
- Section 857 (a) (24) would repeal DFA section 953(b) requiring the calculation and disclosure by public companies of their ratio of median to CEO pay.
- Section 857 (a) (25) would repeal DFA section 955 requiring public companies to report employee or Board member hedging of equity securities granted as compensation.
- Section 857 (a) (26) would repeal DFA section 956 requiring financial regulators to issue rules limiting incentive-based compensation arrangements.

CFTC Reforms

Most CFTC reforms included in the FCA from the last Congress have been deleted, and the following take their place:
• Section 871 would require the “harmonization” of derivatives rules between the CFTC and SEC. There is some concern that while harmonization would have been desirable early in the process, but now that systems are up and running it is likely to be costly and counterproductive to revisit and significantly change things.
• Section 872 would clarify that the CFTC cannot regulate swaps between affiliates.

Provisions Liberalizing and Updating Capital Markets Regulations

Certain provisions will ease compliance burden for small public companies. The two points below have been targeted by ABA members in the past.

• Publicly registered BHCs or SLHCs with annual gross revenues under $250 million or that are considered emerging growth companies would be exempt from filing their financial statements with the SEC in XBRL format.
• Additional time would be afforded for compliance with internal audit requirements for publicly registered BHCs or SLHCs that are considered emerging growth companies.

Other provisions liberalizing crowdfunding and securities offering disclosure document requirements could incrementally ease capital raising for small public BHCs, SLHCs, banks or savings associations.

J. Enhanced Penalties for Fraud and Deception; Enforcement Coordination and Modification

Title II substantially increases penalties for a variety of federal securities law violations as well as those established under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. These increases could have unintended consequences and in particular the potential to change how banks assess the cost of settling (which could now be more expensive) versus litigating.

The FCA also makes a number of changes to the enforcement structure at the Securities and Exchange Commission (SEC) and Public Accounting Oversight Board (PCAOB), which may be of interest to publicly traded banks or banks with divisions that regularly operate in securities markets. Among other changes, it would:

• Increase the maximum civil and criminal penalty amounts that can be assessed under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 for violations involving financial institutions from $1 million to $1.5 million;
• Require the SEC to incorporate economic analysis in its deliberations on enforcement matters, and provide defendants in SEC administrative proceedings a right of removal to federal court; and
- Increase the statutory cap for the most serious securities law violations to $300,000 per violation for individuals and $1.45 million for companies, and allow the SEC to triple the monetary fines sought in both administrative and civil actions in certain cases.

K. Credit Unions

As previously noted, the FCA does not expand credit union powers, but Section 541 requires a more transparent budget process within the NCUA. This is a very important issue for credit union trade associations in recent years, but is not something on which ABA has taken a position. Also, section 586 requires the NCUA to report annually how it allocates expenses between its prudential and insurance-related activities and how these expenses are paid.

Conclusion

The Financial CHOICE Act represents a good step forward in addressing many of the key issues facing our members. In particular, the emphasis on regulatory relief and major reforms of highly problematic provisions of the Dodd-Frank Act are very helpful. However, as set forth in this analysis, there are several issues that require further thought and discussion and perhaps modifications as the process moves forward.