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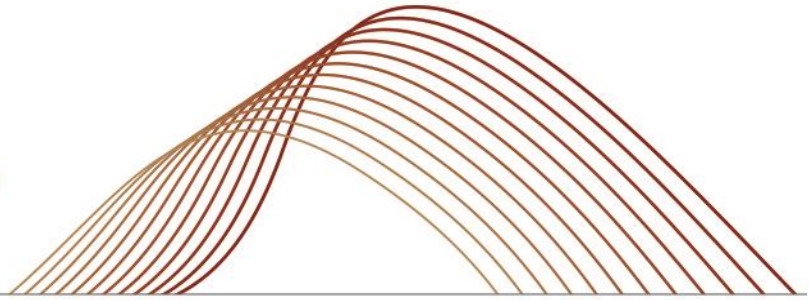

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Reports of Dodd-Frank's Death Are Greatly Exaggerated

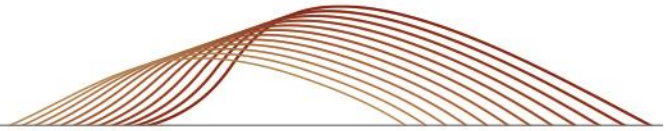
By Lawrence D. Kaplan, Dina Ellis Rochkind & Joshua S. Downer

Enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155 (the "Relief Bill")[1] on May 24 represents the first significant statutory modification to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") since the Dodd-Frank Act was adopted in 2010. Although vaunted by proponents as dismantling the purported regulatory overreach of the Dodd-Frank Act, and excoriated by the opponents of deregulation as decimating critical protections to the financial system, the impact of the Relief Bill as enacted is in reality rather modest with respect to bank regulation. The Relief Billalso is an engine to implement a variety of changes to the U.S. securities laws for the purpose of enhancing capital formation. These changes are the subject of a separate Paul Hastings *Stay Current.*

Amending the Dodd-Frank Act

The Dodd-Frank Act, enacted in 2010 in the aftermath of the financial crisis, represented the most profound restructuring of the financial system since the Great Depression. Enhanced prudential regulation of large bank holding companies was an important part of these reforms. The Dodd-Frank Act also dramatically increased regulatory oversight of the financial system, creating the Bureau of Consumer Financial Protection and the Financial Stability Oversight Council, while substantially expanding the supervisory and examination powers of the prudential regulators—the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Dodd-Frank Act further added new requirements impacting a broad spectrum of financial entities and services across the financial system: revising bank capital and leverage requirements; establishing the "Volcker Rule" (which restricts proprietary trading and investments in certain funds by banking institutions); creating a new regime for regulating swaps and derivatives; and adding significant new provisions related to securities laws, executive compensation, corporate governance, private equity funds, hedge funds and credit rating agencies. The Relief Bill does not alter this heightened financial regulatory landscape. Instead, the Relief Bill, for the most part, modifies the applicability of certain requirements to a smaller subset of banking institutions that are not likely to pose a systemic risk. The Relief Bill also addresses certain regulatory issues, such as the treatment of brokered deposits, and adds a variety of mortgage and consumer-related provisions.

The Dodd-Frank Act imposes a tiered regulatory framework, providing that entities exceeding specified size thresholds face more stringent prudential regulations than their smaller peers. The most heralded and significant change in the Relief Bill raises the threshold for applicability of enhanced prudential



standards from $50 billion in total consolidated assets to $250 billion, reducing the number of banks covered under those provisions from 38 to 12.[2] Those standards include risk-based capital requirements and leverage limits, liquidity requirements, resolution planning, credit exposure reporting and concentration limits.[3] When initially enacted, the $50 billion threshold in the Dodd-Frank Act was adopted, not based on an empirical analysis that institutions with total consolidated assets greater than $50 billion posed systemic risk, but because $50 billion appeared to be a large number. Institutions that pose systemic risk to the U.S. economy are widely regarded to be those entities with over $250 billion in total consolidated assets. Nevertheless, the Relief Bill delays for 18 months the exemption's effectiveness for banks between the $100 billion and $250 billion thresholds, and defers to the Federal Reserve the choice to impose the full suite of enhanced prudential standards on that category of banks if they are determined to pose systemic risk.[4] Additionally, these banking institutions are subject to periodic supervisory stress tests.

Key Changes Impacting Small Banking Entities

The increase in the enhanced prudential standard threshold is consistent with other provisions in the Relief Bill intended to provide regulatory relief for community banks. Principally, these provisions exempt banks with less than $10 billion in assets from the so-called Volcker Rule and from increased capital standards. The Volcker Rule, which restricts proprietary trading or acquiring an interest in covered funds, will no longer apply to banking entities with less than $10 billion in total consolidated assets and total trading assets and with trading liabilities of 5% or less of total assets.[5] While most small institutions do not engage in the types of proprietary trading or investments in covered funds that the Volcker Rule seeks to prevent, under the Dodd-Frank Act and the regulations promulgated thereunder, such institutions had to spend considerable resources to prove the negative by documenting that their activities did not violate the Volcker Rule. Moreover, as discussed in more detail below, the Relief Bill grants capital relief to certain small institutions that do not pose a systemic risk, which frees up capital to be lent in their communities. While these changes to small banks will have a positive impact on the banking entities affected, the broad regulatory framework established by the Dodd-Frank Act remains firmly in place.

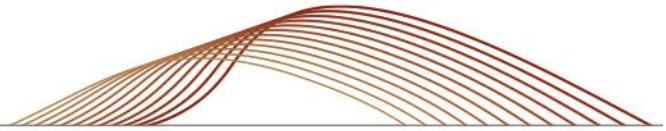
Additional Changes to Small and Medium-sized Banking Entities

As a result of the Relief Bill, small institutions, which are typically community banks, obtain additional regulatory relief through a variety of provisions.

Specifically, institutions with less than $3 billion in assets:

- can be eligible for an 18-month examination cycle;[6] and
- will be subject to the Federal Reserve's Small Holding Company Policy Statement, which enhances capital raises by small banks and savings and loan companies and allows operations with higher levels of debt than normal holding companies, as well as exempts such holding companies from consolidated risk-based and leverage capital rules.[7]

Institutions with less than $5 billion in total assets will be permitted to file short-form call reports for their second and fourth call reports each year.[8]



Institutions with less than $10 billion in total assets:

- will be considered well capitalized and deemed to satisfy generally applicable leverage and risk-based capital requirements by maintaining a leverage capital ratio between 8–10%, which has the effect of providing an exemption from the complex Basel III capital regime;[9]
- are now permitted to offer mortgages not subject to strict federal underwriting requirements, under certain conditions, and to qualify for legal protections afforded to qualified mortgages without meeting all of the typical requirements, such as the "ability to repay requirement";[10] and
- are exempted from a corporate governance requirement to establish a risk committee until they have $50 billion in total assets.

Institutions with greater than $50 billion in total consolidated assets will be exempted from:

- periodic stress tests, certain risk-based capital requirements, leverage limits, liquidity requirements, resolution planning, credit exposure reporting and concentration limits until they hold $250 billion in total consolidated assets.[11]

In addition to reducing the regulatory burden imposed upon small banking institutions by the Dodd-Frank Act, the increased exemptions likely will stimulate growth—organically or by merger or acquisition—as additional regulatory requirements emanating from such growth will not be triggered as quickly.

Other Key Provisions of the Relief Act Impacting Banks

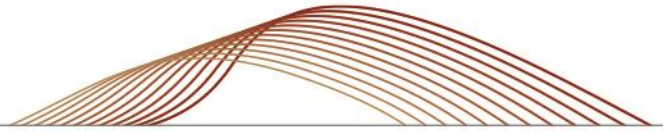
Brokered Deposit Reform for Reciprocal Deposits

All banks with a CAMELS rating of 1 or 2 will be able to hold the lesser of $5 billion or 20% of their total deposits in reciprocal deposits without having to treat them as brokered.[12] This significant amendment to Section 29 of the Federal Deposit Insurance Act rolls back years of FDIC treatment of a form of deposit commonly believed to have the attributes of core deposits. This provision provides a clear safe harbor from a brokered deposit classification, which will have the benefit of lowering deposit insurance premiums.

Additional Banking Provisions

The Relief Bill includes other miscellaneous changes to the banking laws, including:

- removing the name-sharing restrictions under the Volcker Rule, to allow sponsored covered funds to share the same name, or a variation of the same name, with a banking organization that acts as investment advisor to the fund, subject to certain conditions;[13]
- adding a new exemption to the capital rules for custody banks;[14]
- facilitating the opening of online accounts for financial products or services with a financial institution by permitting an electronic scan of a customer's driver's license or personal identification card in connection with the account opening process;[15]
- allowing savings associations with less than $20 million in total consolidated assets to be treated similarly to national banks, thereby exempting them from the qualified thrift lender



test and limitations on commercial and consumer lending under the Home Owners' Loan Act;[16] and

- changing the treatment of certain investment grade municipal securities for purposes of calculating the liquidity coverage ratio.[17]

Additional Mortgage Provisions

The Relief Bill provides that all banks that originate less than 500 mortgages a year will be exempt from the Home Mortgage Disclosure Act requirements imposed by the Dodd-Frank Act, which could make it more challenging to identify patterns of discriminatory lending practices by small banks.[18] The Relief Bill further:

- amends the Truth in Lending Act to provide that a retailer of manufactured homes is not regulated as a "mortgage originator," subject to certain requirements;[19]
- amends the S.A.F.E. Mortgage Licensing Act of 2008 to eliminate barriers to jobs for loan originators;[20]
- adds protections to preserve access to Habitat for Humanity homes;[21]
- exempts real estate in certain rural areas from appraisal requirements;[22] and
- amends the Federal Credit Union Act to eliminate the requirement that a primary residence be used as collateral for a fully secured loan on a one-to-four family home.[23]

Consumer Protection Provisions

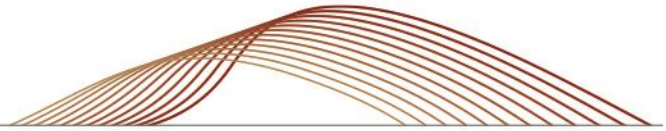
As a result of various credit bureau hacks that have occurred recently, the Relief Bill includes measures to help consumers as they respond to attacks on their data. These provisions allow consumers to place security freezes on their credit reports at no charge and prohibit a consumer reporting agency from disclosing the contents of a consumer report after a security breach pending the consumer's removal of the security freeze, with limited exceptions.[24] Consumers may also request that credit reporting agencies include a fraud alert on their files for at least one year, and businesses that see such an alert must verify the consumer's identity before extending new credit.[25]

The Relief Bill also adds protections related to student borrowers. Most notably, lenders may not declare default or accelerate repayment of a loan when a co-signer dies or declares bankruptcy, and a co-signer is released from obligations if the student borrower dies.[26] Provisions are included to protect veterans from reporting of medical debts resulting from inappropriate or delayed payment for medical services by the U.S. Department of Veterans Affairs.[27]

Changes to the Securities Laws to Encourage Capital Formation

While most of the Relief Bill is intended to tame restrictions in existing federal banking law, Section 5 of the Relief Bill addresses provisions of federal securities laws to encourage capital formation. Section 5:

- expands the exemption from certain state securities laws to include all securities listed or authorized for listing on a national securities exchange;
- expands Regulation A+ offerings to reporting companies;



- increases the amount of securities that may be sold under Rule 701 in a 12-month period without having to provide additional disclosures;
- provides an exemption to Investment Company Act registration for certain "Qualifying Venture Capital Funds";
- eliminates the Investment Company Act exemption for U.S. possessions;
- requires the Securities and Exchange Commission (the "SEC") to adopt rules to provide closed-end companies with parity with other reporting companies regarding the use of securities offering and proxy rules;
- requires the SEC to report to Congress on algorithmic trading in U.S. capital markets;
- requires the SEC to review and respond to the findings and recommendations of the annual government–business forum on capital formation; and
- requires the SEC, in certain circumstances, to offset future fees and assessments due from a national securities exchange by prior overpayments.

For a more detailed description of Section 5 of the Relief Bill, please see our separate Paul Hastings *Stay Current* publication entitled "Dodd-Frank Relief Bill Includes Provisions to Encourage Capital Formation."

A First Step to Further Deregulation?

Prior to the passage of the Relief Bill, most Congressional Democrats appear to have treated the Dodd-Frank Act like Biblical text that could not be changed. The Relief Bill demonstrates that the Dodd-Frank Act's provisions are not immutable. Going forward, we expect to see Congress pursue further changes to rein in provisions of the current financial regulatory regime.

Conclusion

The Relief Bill represents a modest refinement of the bank regulatory framework imposed by the Dodd-Frank Act. While we believe additional reform is possible, the Relief Bill represents a bipartisan effort to address some concerns about over-regulation since implementation of the Dodd-Frank Act began. Nonetheless, the heightened bank regulatory framework established by the Dodd-Frank Act remains in place. The Relief Bill has brought some regulatory relief to banking institutions, but to borrow a phrase attributed to the great American writer Mark Twain, the widely reported death of the Dodd-Frank Act is an exaggeration.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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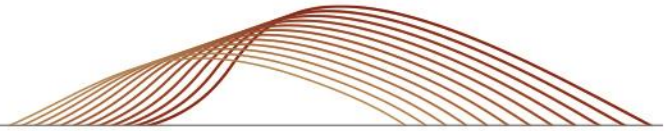

[1] S. 2155, Economic Growth, Regulatory Relief, and Consumer Protection Act ("Relief Bill"). The Relief Bill is available at https://www.congress.gov/bill/115th-congress/senate-bill/2155.

[2] *See* American Banker, "Congress Seals Deal on Dodd-Frank Reforms" (May 22, 2018).

[3] 12 U.S.C. § 5365(b)(1)(A).

[4] Relief Bill at Title IV, Sec. 401(a)(1).

[5] Relief Bill at Title II, Sec. 203.

[6] Relief Bill at Title II, Sec. 210.

[7] Relief Bill at Title II, Sec. 207.

[8] Relief Bill at Title II, Sec. 205.

[9] Relief Bill at Sec. 201(a), (b).

[10] Relief Bill at Title I, Sec. 101.

[11] Relief Bill at Title IV, Sec. 401(a)(4), (5).

[12] Relief Bill at Title II, Sec. 202.

[13] Relief Bill at Title II, Sec. 204.

[14] Relief Bill at Title IV, Sec. 402(b).

[15] Relief Bill at Title II, Sec. 213.

[16] Relief Bill at Title II, Sec. 206.

[17] Relief Bill at Title IV, Sec. 403.

[18] Relief Bill at Title I, Sec. 104.

[19] Relief Bill at Title I, Sec. 101.

[20] Relief Bill at Title I, Sec. 106.

[21] Relief Bill at Title I, Sec. 102.

[22] Relief Bill at Title I, Sec. 103.

[23] Relief Bill at Title I, Sec. 105.

[24] Relief Bill at Title III, Sec. 301.

[25] *Id.*

[26] Relief Bill at Title V, Sec. 601.

[27] Relief Bill at Title III, Sec. 303.