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Regulatory Relief: What to Expect

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Where are we?

Dodd-Frank Act

- July 21, 2010
- Circa 370,000 words.
- Major issues addressed:
  - Financial stability
    - Oversight of nonbank SIFIs
    - Enhanced requirements for banking organizations with total assets of greater than $50 billion
      - Liquidity requirements
      - Overall risk management requirements
      - Resolution planning
      - Concentration limits
      - Contingent capital
      - Short-Term debt limits
      - Risk committee requirement

Dodd-Frank Act, cont'd.

- Enhanced requirements for banking organizations with total assets of greater than $50 billion
  - Stress tests
  - Leverage limit
  - Capital on off balance sheet activities
  - Trickle down
- Orderly liquidation
- Elimination of OTS
- Regulation of advisers
- Federal Insurance Office
- Changes to bank and holding company supervision and regulation
  - Volcker Rule
- Regulation of derivatives
- Oversight of payment clearing and settlement systems
- Changes to the supervision and regulation of securities activities

- Creation of the Consumer Financial Protection Bureau
  - Jurisdiction over virtually all federal consumer financial protection laws
  - UDAAP rule writing authority
  - Jurisdiction over non bank providers of consumer financial products and service
  - Broad enforcement powers
- Mortgage underwriting standards

Dodd-Frank Act, cont'd.

Basel III

- New higher capital levels
- Limitations on capital instruments
- New risk weights
- Capital conservation buffer (CCB)
- Countercyclical capital buffer (CCyB)
- Liquidity Coverage Ratio (LCR)
- Net Stable Funding Ratio (NSFR)
- Total loss absorbing capacity (TLAC)
- G-SIB surcharge

What's Left?

- Most, but not all rules have been adopted
- Some are still proposed
  - For example, the rules relating to incentive-based compensation
- Some are still phasing in
  - For example, capital rule phase-in
- Housing finance has not been addressed

Avenues for Change

Three Avenues for Change

- Changes in supervisory discretion
  - Prosecutorial discretion
    - Consent orders
    - MOUs
    - MRIAs
    - MRAs
    - Exam reports
  - No requirements for notice and comment
  - No delayed effective dates
  - New agency appointments may be key
    - Most financial regulatory agencies are independent and not subject to executive orders
      - May comply with the spirit of executive orders
      - CFPB?
    - It may take awhile for the message to get to field examiners
  - Limited by statutes and rules

- Rule changes
  - Notice and comment generally required
    - Need to justify the change
  - Broad discretion in capital and liquidity numbers
  - Less discretion in some of the consumer rules
  - Interagency rules like the Volcker Rule are likely to take more time
- Statutory Changes
- Congressional Review Act
  - Can invalidate new and recent agency rules

Three Avenues for Change, cont'd.

CCAR

- In January 2017 the Federal Reserve adopted a final rule that revises the capital plan and stress test rules under the Dodd-Frank Act
- Establishes new class of BHCs with at least $50 billion in total consolidated assets—"large" and "noncomplex" firms that are subject to less stringent requirements than other BHCs subject to CCAR
- A large and noncomplex firm:
  - maintains total consolidated assets of at least $50 billion but less than $250 billion,
  - maintains nonbank assets of less than $75 billion, and
  - is not classified as a U.S. G-SIB

- These firms are:
  - No longer subject to the qualitative component of CCAR
  - Benefit from the modification of certain regulatory reporting requirements under the Federal Reserve's capital plan rule
  - Will be subject to Fed supervisory review of capital plans in a manner similar to existing supervisory programs
- For BHCs with greater than $50 billion in TCAs, the rule simplifies the initial applicability provisions for the capital plan and stress test rules, and provides additional time before those requirements apply to BHCs that cross the $50 billion threshold near the April 5 capital plan submission and stress test date

CCAR, cont'd.

Executive Orders

Presidential Actions in 2017

- On January 30, 2017, President Trump issued an Executive Order, titled *Reducing Regulation and Controlling Regulatory Costs*.
  - Notes that the policy of the executive branch is to be "prudent and financially responsible in the expenditure of funds, from both public and private sources."
  - Establishes a regulatory cap for fiscal year 2017—unless prohibited by law, whenever an executive department or agency publicly proposes for notice and comment (or otherwise promulgates a new regulation), it must identify <u>at least two</u> existing regulations to be repealed.
- On February 2, 2017, the Office of Information and Regulatory Affairs issued its *Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017*.
  - Explains that departments and agencies may comply with the requirements of the Executive Order "by issuing two 'deregulatory' actions for each new significant regulatory action that imposes costs."

Executive Orders

- On February 24, 2017, President Trump issued an Executive Order, Enforcing the Regulatory Reform Agenda
  - Requires regulatory reform officers and regulatory reform task forces in each agency
  - Identify regulations that:
    - Eliminate jobs, or inhibit job creation;
    - Are outdated, unnecessary, or ineffective;
    - Impose costs that exceed benefits;
    - Create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies;
    - Are inconsistent with the requirements of section 515 of the Treasury and General Government Appropriations Act, 2001 (44 U.S.C. 3516 note), or the guidance issued pursuant to that provision, in particular those regulations that rely in whole or in part on data, information, or methods that are not publicly available or that are insufficiently transparent to meet the standard for reproducibility; or

- derive from or implement Executive Orders or other Presidential directives that have been subsequently rescinded or substantially modified.

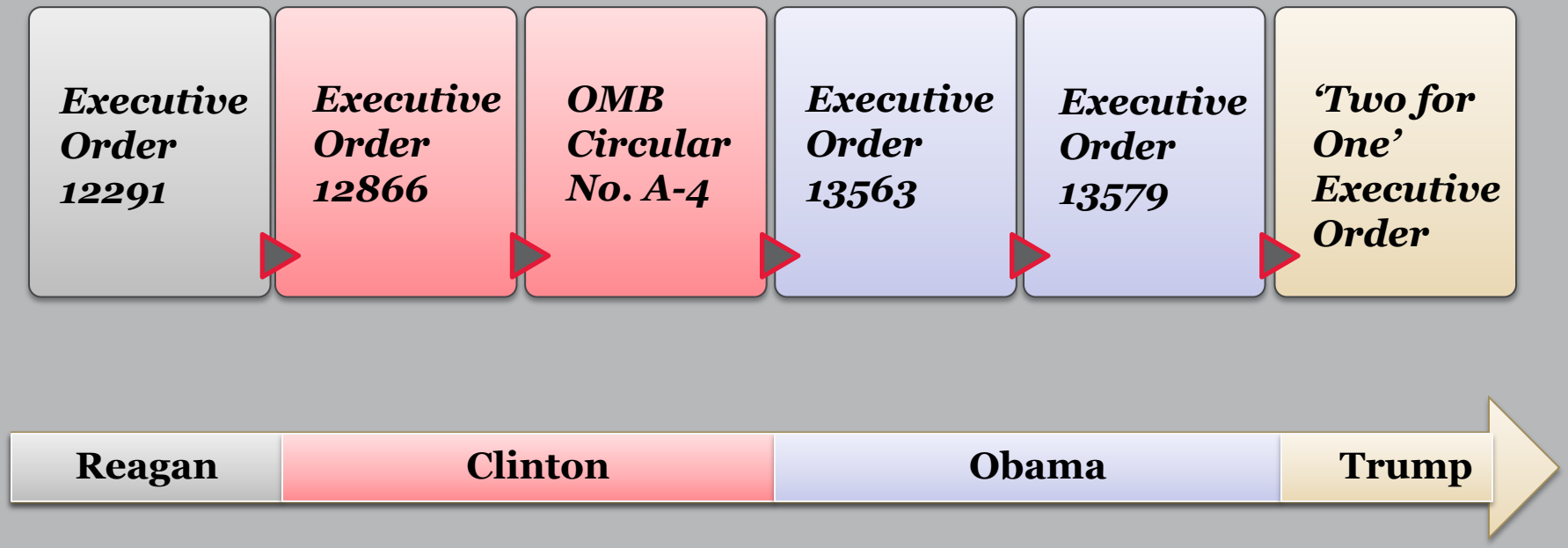
- Within 90 days and thereafter report on progress, including identifying regulations for repeal, replacement or modification

Executive Orders, cont'd.

Core Principles for Regulating the United States Financial System

- On February 3, 2017, President Donald Trump signed the Executive Order on Core Principles for Regulating the United States Financial System. The order outlined seven principles of regulation, or "Core Principles", which the Trump Administration will follow to regulate the U.S. financial system. The principles were listed as follows:
  - Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
  - Prevent taxpayer-funded bailouts;
  - Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;
  - Enable American companies to be competitive with foreign firms in domestic and foreign markets;
  - Advance American interests in international financial regulatory negotiations and meetings;
  - Make regulation efficient, effective, and appropriately tailored; and
  - Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

Cost-Benefit Requirements Within the Rulemaking Process



Cost-Benefit Requirements Within the Rulemaking Process: Pre-Trump

- ***Executive Order 12291 (Feb. 1981)***.
  - Regulatory Impact Analysis must be conducted in connection with every "Major Rule."
  - Must contain a description of the potential: (i) benefits of rule; (ii) costs of rule; and (iii) net benefits of rule.
- ***Executive Order 12866 (Oct. 1993)*** *(revokes Executive Order 12291)*. Agencies should assess all costs/benefits of viable regulatory alternatives, including the alternative of not regulating.
  - "Significant" regulatory actions must be submitted to Office of Information and Regulatory Affairs ("OIRA") for review.
- ***OMB Circular A-4 (Sept. 2003)***. Designed to ". . . standardiz[e] the way benefits and costs of Federal regulatory actions are measured and reported."
  - "Good regulatory analysis" encompasses: (i) a statement of the need for a proposed action; (ii) an examination of alternative approaches; and (iii) an evaluation of benefits and costs, including cost-benefit and cost-effectiveness analyses.
  - To properly evaluate costs and benefits of regulations and alternatives, an agency must:
    - Explain how the actions required by the rule are linked;
    - Identify a baseline; and
    - Identify the expected undesirable side-effects and ancillary benefits.
  - "Opportunity cost" is the appropriate concept for valuing benefits and costs.
    - "Willingness-to-pay" captures the notion of opportunity cost.
    - However, "willingness-to-accept" can also be instructive.

- ***Executive Order 13563 (Jan. 18, 2011)***
  - Regulatory system must "take into account benefits and costs, both quantitative and qualitative" and measure "the actual results of regulatory requirements.
  - Each executive agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.
  - Where feasible, executive agencies should consider values that are "difficult or impossible to quantify" (e.g., equity, human dignity, fairness and distribute impacts).
- ***Executive Order 13579 (July 11, 2011)***
  - Extends Executive Order 13563 to independent regulatory agencies.
  - Independent regulatory agencies should consider how best to promote "retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome . . ."

Pre-Trump, cont'd.

The Choice Act

The Financial Choice Act

- The Financial Choice Act of 2016 (the "Choice Act") is viewed as the first major concerted effort to provide an alternative to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") as a way to end "Too Big to Fail."
- The Choice Act addresses a broad range of issues:
  - Capital election
  - Curtailing systemic provisions of Dodd-Frank Act
  - CFPB reform
  - Durbin repeal
  - Fiduciary rule repeal
  - Regulatory "accountability" measures
  - Volcker Rule repeal
  - Mortgage reform
  - Securities rules changes

The Choice Act

- Capital election provisions

Qualification Criteria:	**BHCs and SHLCs must maintain a ratio of average tier 1 common equity, and additional tier 1 capital instruments issued on or before June 1, 2016,[1] to total leverage exposure, as measured for purposes of the supplementary ratio, of 10% for itself (and each IDI), and each IDI must maintain a CAMELS rating of 1 or 2**
Section	Exemptions
102(a)(1)	Exempts from regulatory capital and liquidity requirements, including: (1) Basel III; (2) supplementary leverage ratio; (3) LCR; and (4) NSFR.
102(a)(2)	Exempts from limitations on capital distributions.
102(a)(3)(A)	Exempts BHCs from any consideration of any risk the BHCs may pose to U.S. financial stability.
102(a)(3)(B)	Exempts from any consideration of limitations on proposed mergers, consolidations, or acquisitions due to concentrations risks to the U.S. financial stability.
102(a)(3)(C) &(D)	Exempts from any consideration of risk to U.S. financial stability in applications by BHCs to engage in nonbanking activities.
102(a)(3)(E)	Exempts from any consideration of whether a merger under the Bank Merger Act would pose a risk to U.S. financial stability.

[1] BHCs with less than $15 billion in consolidated assets can include certain TruPS issued before May 19, 2010, and for traditional banking organizations with no trading assets and limited swaps, the leverage exposure is limited to Call Report assets minus tier 1 capital deductions.

Qualification Criteria:	BHCs and SHLCs must maintain a ratio of average tier 1 common equity, and additional tier 1 capital instruments issued on or before June 1, 2016, to total leverage exposure, as measured for purposes of the supplementary ratio, of 10% for itself (and each IDI), and each IDI must maintain a CAMELS rating of 1 or 2
Section	Exemptions
102(a)(3)(F)	Exempts SLHCs from consideration of any risk the SLHC may pose to U.S. financial stability.
102(a)(4)	Exempts BHCs from the 10% deposit cap on interstate acquisitions, removes the $10b cap on FHCs acquiring companies without prior approval, and exempts the BHC from the 10% cap on consolidated liabilities.
102(a)(5)	Exempts the IDIs from the 10% deposit cap on mergers.
102(a)(6)	Exempts BHCs with total consolidated assets >$50b from the approval requirements for acquisitions >$10b.
102(a)(7)	Exempts SHLCs from the 10% deposit cap.
102(a)(8)	Exempts BHCs with >$50b from Dodd-Frank Section 165, and similar requirements relating to prudential standards, including: (1) risk based or leverage capital; (2) liquidity; (3) overall risk management, including a risk committee; (4) concentration limits; (5) contingent capital requirements; (6) enhanced disclosures; (7) short-term debit limits; and (8) resolution planning and credit exposure reports.
102(a)(9)	Exempts from any federal limitations on mergers, consolidations, or acquisitions of assets or control, to the extent such limitations relate to capital or liquidity standards or concentrations of deposits or assets.
102(b)	Exempts certain banking organizations with consolidated assets of between $10b and $50b from annual stress tests.
102(c)	IDIs are deemed well capitalized for purposes of prompt corrective action.

The Choice Act, cont'd.

Choice Act 2.0

- Off-ramp provisions likely will be based on Tangible Equity Leverage Ratio (TELR)

$$\text{TELR} = \frac{(\text{CET1} + \text{Preferred Stock issued prior to 6/1/16})}{\text{Applicable Exposure Measure}}$$

- 10% minimum TELR required for off-ramp
- Applicable Exposure Measure will depend upon activities
  - Traditional Banking Organization: less stringent calculation
  - Non-Traditional Banking Organization: total leverage exposure from SLR rule is used
- Off-ramp entities would be exempt from stress tests

- Act would repeal Volcker Rule
- Choice Act 2.0 takes a more aggressive stance toward the CFPB
- For example, under Choice Act 2.0, CFPB is to be retained and re-structured as a civil law enforcement agency similar to the Federal Trade Commission, with additional restrictions on its authority:
  - Sole director, removable by the President at-will
  - Elimination of consumer education functions
  - Rule-making authority limited to enumerated statutes
  - UDAP authority repealed in full
  - Supervision repealed
  - Consumer compliant database repealed
  - Market monitoring authority repealed
  - Enforcement powers limited to cease and desist and CID/Subpoena powers
  - Mandatory advisory boards repealed
  - Research function eliminated
  - Strengthen the existing Dodd-Frank language that the CFPB's jurisdiction does not include entities regulated by either the SEC or CTFC.

Choice Act 2.0, cont'd.

Choice Act Securities and Disclosure Provisions

The Choice Act

Reforms to Title IX of the Dodd-Frank Act:	
Fiduciary Duty Rule	• Requires the SEC to report to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs on certain matters before promulgating a heightened standard of conduct for broker-dealers.
Asset-Backed Securities and Credit Rating Agencies	• Eliminates the risk retention requirements for certain asset-backed securities. • Repeals the Franken Amendment.
Relief for Smaller Issuers	• Modifies threshold for ability to rely on the exemption from Section 404(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").
Executive Compensation, Incentive-Based Compensation, and Pay Ratio Disclosure	• Repeals the Dodd-Frank Act provisions relating to incentive-based compensation and pay ratio disclosures.

The Choice Act: Reforms Affecting Capital Formation

Title X of the Financial Choice Act			
Simplification of Small Business Mergers, Acquisitions, Sales, and Brokerage	Encouraging Employee Ownership	Foster Innovation Through Temporary Exemption for Low-Revenue Issuers	Safe Harbor for Micro Offerings
Simplification of Small Company Disclosure Requirements	SEC Overpayment Credit	Enhance Small Business Capital Formation	Improvements to Private Placements
Accelerating Access to Capital	Fair Access to Investment Research	Revisions to the Prohibition Against General Solicitation and Advertising	Investor Limitations for Qualifying Venture Capital Funds
Establishment of an SEC Small Business Advocate	Small Business Credit Availability	Venture Exchanges	Adjustments to Crowdfunding Regime

The Choice Act: Repeal of Certain Specialized Public Company Disclosures

Would repeal the following provisions of the Dodd-Frank Act:	
Section 1502	• Requires certain persons to disclose annually whether any "conflict minerals" are necessary to the functionality or production of a product of the person originated in the Democratic Republic of the Congo or an adjoining country.
Section 1503	• Requires the SEC to promulgate rules that require an issuer that files reports pursuant to Section 13(a) or Section 15(d) of the Exchange Act and is an operator, or maintains a subsidiary that is an operator, of a coal or other mine to include, in each periodic report filed with the SEC, certain information for the time covered by the report.
Section 1504	• Requires that the SEC issue rules that require reporting issuers engaged in resource extraction activities, including the commercial development of oil, natural gas, or minerals, to disclose in their annual reports certain payments made to the U.S. federal government or a foreign government.

Changes to the as-introduced Version of the Financial Choice Act

- The Choice Act 2.0 contains additional provisions that would:
  - Modernize Section 12(g) registration requirements for smaller reporting companies.
    - Eliminate annual verification of accredited investor status; and
    - Increase revenue and shareholder thresholds.
  - Increase the exemption from registration as an investment company for "qualified angel funds" from 100 to 500 investors.
  - Increase the SEC Rule 701 threshold from $10 to $20 million with an inflation trigger.
  - Extend the ability to "test the waters" to all companies (not just EGCs).
  - Confidential filings will be available to all companies registering shares for sale for the first time.
  - Increase the Reg A+ $50 million threshold to $75 million per year plus the addition of an inflation trigger.

Aspects of the Choice Act Already in Motion: Pay Ratio Disclosure Rule

- The SEC adopted the Pay Ratio Disclosure Rule in August 2015 to implement Section 953(b) of the Dodd-Frank Act.
- The Pay Ratio Disclosure Rule requires a public company to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer.
- On February 6, 2017, Acting Chairman of the SEC Michael Piwowar requested public comment on any unexpected challenges that issuers have experienced in connection with complying with the Pay Ratio Disclosure Rule.

Aspects of the Choice Act Already in Motion: Public Company Disclosures

- On January 31, 2017, Acting Chairman of the SEC Michael Piwowar directed the SEC staff to "reconsider whether the 2014 guidance on the Conflict Minerals Rule is still appropriate and whether any additional relief is appropriate."
- On February 14, 2017, President Trump approved Congress' joint resolution to repeal the SEC's Resource Disclosure Rule.
  - The joint resolution was passed by Congress in February 2017 pursuant to the Congressional Review Act.
  - The Congressional Review Act permits Congress to, among other things, disapprove a final agency rule within 60 days from when it was issued.

SEC Examination and Enforcement Developments

SEC Examination Priorities

- The SEC's National Examination Program ("NEA") of the Office of Compliance Inspections and Examinations ("OCIE") announced that its examination priorities in 2017 will focus on three general areas: retail investors, risks specific to elderly investors and retirement investing, and assessing market-wide risks.
- Robo-advisers.
  - The OCIE will focus on so-called "robo-advisers" that provide automated online investment advice. In particular, OCIE will examine compliance practices for overseeing the advisers' algorithms that generate investment recommendations.
- Wrap fee programs.
  - The OCIE will expand its focus on wrap fee programs, which charge investors a bundled fee for advisory and brokerage services. Examinations will focus on investor suitability, disclosures, and conflicts of interest. Some wrap fee programs in the past have been scrutinized for "reverse churning," a practice that minimizes trades in a client's account to reduce out-of-pocket expenses to an adviser charging a fixed fee.

- Exchange-traded funds.
  - The OCIE will focus on how ETFs comply with their exemptive orders. In addition, OCIE will review sales practices and suitability of broker-dealer ETF recommendations.
- Never-before examined investment advisers.
  - OCIE will continue its program of focusing on newly formed advisers and those that have never been examined.
- Recidivism.
  - The OCIE will step up its attempts to identify repeat offenders at investment advisers and broker-dealers.
- Multi-branch advisers.
  - The OCIE will continue to focus on advisers that provide advisory services from multiple locations. OCIE published compliance guidelines for multi-branch advisers in December 2016, which provide a clue to what multi-branch advisers can expect from examiners.
- OCIE will continue to emphasize examinations of advisers and broker-dealers that recommend sales of variable insurance products and target date funds for retirement accounts. OCIE also will look at how pension plans of government entities manage conflicts of interest in managing those investments and focus on "interactions" with senior investors with a view to identify "financial exploitation."

SEC Examination Priorities, cont'd.

- Money market funds.
  - The OCIE will focus on how money market funds comply with recent changes to the rules that govern them.
- Payment for order flow.
  - The OCIE will focus on ensuring that broker-dealers comply with their duty to seek best execution when routing customer orders for execution.
- Clearing agencies.
  - Using a risk-based approach, OCIE will continue to focus on "systemically important" clearing agencies, pursuant to authority provided by Dodd-Frank.
- FINRA.
  - The OCIE will enhance its oversight of FINRA, including inspections of FINRA's operations and regulatory programs.
- Regulatory systems compliance and integrity ("SCI").
  - The OCIE will step up examinations of SCI entities to ensure the integrity and efficiency of their systems, including enterprise risk management.
- Cybersecurity.
  - Cybersecurity continues to be a top priority of OCIE examiners.

SEC Examination Priorities, cont'd.

- National securities exchanges.
  - The OCIE will continue risk-based examinations of national securities exchanges, focusing on operational and procedural controls.
- Anti-money laundering ("AML").
  - The OCIE will look at broker-dealer AML programs to ensure they are tailored to address specific risks and how they monitor for suspicious activity.
- OCIE will also allocate resources to examinations of municipal advisors, transfer agents and private fund advisers, with particular focus on conflicts of interest.

SEC Examination Priorities, cont'd.

SEC Enforcement

- Changes can be expected
  - More cases being settled and less headline seeking enforcement litigation
  - Less onerous restrictions on foreign public companies
  - Less zealous enforcement of Foreign Corrupt Practice Act
    - Clayton has expressed views on a less zealous approach to FCPA, but that was before the DOJ and the SEC targeted many non-US Companies; the DOJ and the SEC collected a total of $1.8 billion in FCPA fines, penalties and disgorgement in 2016.
    - Clayton questioned the unilateral approach of the US and, since his comments, the DOJ and the SEC have accomplished much in building international coalitions and relationships with law enforcement agencies around the globe. In effect, the DOJ and the SEC have "institutionalized" global anti-corruption enforcement, and it will be extremely difficult for any future administration to dismantle this existing infrastructure.

- Changes can be expected (cont'd)
  - Settlements are more likely to seek new safeguards, not fines that punish stockholders

SEC Enforcement, cont'd.