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Regulatory Burden Relief: What to Anticipate

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Dodd-Frank

Dodd-Frank Act

- Signed into law on July 21, 2010
- Circa 370,000 words
- Major issues addressed:
  - Financial stability
    - Oversight of nonbank SIFIs
    - Enhanced requirements for >$50 billion banking organizations
      - Liquidity requirements
      - Overall risk management requirements
      - Resolution planning
      - Concentration limits
      - Contingent capital
      - Short-term debt limits
      - Risk committee requirement
      - Stress tests requirement
      - Leverage limit
      - Capital required for off-balance sheet activities
      - Trickle down

Dodd-Frank Act, cont'd.

Major issues, cont'd.

- Orderly liquidation
- Elimination of OTS
- Regulation of advisers
- Federal Insurance Office
- Changes to bank and holding company supervision and regulation
  - Volcker Rule
- Regulation of OTC 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 nonbank providers of consumer financial products and service
  - Broad enforcement powers
- Mortgage underwriting standards

Basel III

Basel III

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

Where Are We?

- Most, but not all, rules implementing the Dodd-Frank Act and Basel III have been adopted
- Some are still proposed
- Some are still phasing in
  - Capital 2019
  - Supplementary leverage ratio (SLR)/enhanced SLR
- 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 a while 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

Three Avenues for Change, 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 titled *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 titled *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.

The Fiduciary Rule

Fiduciary Rule

- On February 3, 2017, President Trump directed the DOL to consider the impact of the Fiduciary Rule on the ability of Americans to gain access to retirement information and financial advice and to prepare an updated economic and legal analysis regarding the Fiduciary Rule
- In response to President Trump's directive, in March and April 2017, the DOL issued notices to extend the Applicability Date 60 days from April 10, 2017, to June 9, 2017
- In late May 2017, Secretary of Labor Acosta announced in a *Wall Street Journal* op-ed piece that the DOL would not seek to extend the June 9, 2017, effective date for the definition of who is a fiduciary and the impartial conduct standards

- The DOL also issued revised versions of the Best Interest Contract Exemption (the "BIC Exemption") and the Principal Transaction Exemption with relaxed requirements to comply with each during a transition period from June 9, 2017, to December 31, 2017 (the "Transition Period")
- In May 2017, the DOL issued a Field Assistance Bulletin regarding its enforcement policy during the Transition Period and another set of FAQs regarding the application of the Fiduciary Rule and applicable exemptions during the Transition Period
- The DOL has left open the possibility that during the Transition Period it may seek to delay implementation dates further, revise the Fiduciary Rule and the BIC and Principal Transaction Exemptions, or propose new exemptions

Fiduciary Rule, cont'd.

- In response to President Trump's memorandum, on June 29, 2017, the DOL issued a Request for Information ("RFI") in connection with its examination of the Final Fiduciary Rule
- The RFI poses two sets of questions
  - The first set of questions asks whether an extension of the applicability date beyond January 1, 2018, for full implementation of the BIC and Principal Transaction Exemptions would reduce burdens on financial service providers and benefit retirement investors by allowing a more efficient implementation or whether such a delay would carry any risk
  - The second set of questions is broader and focuses on the substantive issues raised in the Presidential memorandum:
    a) What actions have already been implemented by the regulated community in order to comply with the Fiduciary Rule and related exemptions, and are there are any market innovations the DOL should consider?
    b) Whether the Fiduciary Rule and related exemptions appropriately balance the interests of consumers while protecting them from conflicts of interest and effectively allow a wide range of products to meet the needs of investors?
    c) To what extent the costs of the exemption conditions exceed their benefits and whether there are better approaches?
    d) What are the likely implications of eliminating or substantially revising the contract and warranty requirements currently included in the BIC and Principal Transaction Exemptions?

Fiduciary Rule, cont'd.

e) Would mutual fund "clean" shares allow financial institutions to develop policies and procedures that avoid compensation incentives to favor one mutual fund over another? What are the legal and practical impediments financial institutions face in adding clean shares to their product offerings?

f) How would advisers be compensated for selling fee-based annuities?

g) Are there innovations other than clean shares, T-shares, and fee-based annuities that hold similar potential to mitigate conflicts and increase transparency?

h) Should the DOL base a streamlined exemption on a model set of policies and procedures?

i) Could a streamlined exemption or other changes be developed for advisers who comply with any updated standards of conduct adopted by the Securities and Exchange Commission?

j) Whether the Principal Transaction Exemption could be improved to better serve investor interests and provide flexibility?

k) How could the BIC Exemption disclosures be simplified? Should the DOL develop model disclosure provisions?

l) Should recommendations to make or increase contributions to a plan or IRA be expressly excluded from the definition of investment advice?

Fiduciary Rule, cont'd.

The Financial 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"
- A revised version of the CHOICE Act, "CHOICE Act 2.0," was approved by the House on June 8, 2017
- 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).
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).
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 are 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

- CHOICE 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 Related Provisions

The CHOICE Act

Reforms to Title IX of the Dodd-Frank Act:	
Fiduciary Duty Rule	• Repeals DOL's fiduciary rule and 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 asset-backed securities other than residential mortgages. • 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 $5 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's 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

U.S. Treasury Department Report on Core Principles for Regulating the U.S. Financial System

U.S. Treasury Department Report

- As required by the President's Executive Order 13772 setting forth the core principles that should be taken into account in connection with the regulation of the U.S. financial system, the U.S. Treasury Department published a report on June 12, 2017, identifying regulations inconsistent with the seven principles articulated in the Order
- The current report addresses only the depository system and defers an evaluation of the orderly liquidation authority established by the Dodd-Frank Act
- The report is the first of a series of reports and we await future reports that address the regulation of the capital markets, the asset management and insurance industries, and nonbank financial services companies

- The report summarizes its recommendations as directed toward:
  - Improving regulatory efficiency and effectiveness by critically evaluating mandates and regulatory fragmentation, overlap, and duplication across regulatory agencies;
  - Aligning the financial system to help support the U.S. economy;
  - Reducing regulatory burden by decreasing unnecessary complexity;
  - Tailoring the regulatory approach based on size and complexity of regulated firms and requiring greater regulatory cooperation and coordination among financial regulators; and
  - Aligning regulations to support market liquidity, investment, and lending in the U.S. economy

U.S. Treasury Department Report, cont'd.

Regulatory Structure

- The report recommends that Congress take steps to reduce fragmentation, overlap and duplication in financial regulation by:
  - Broadening the FSOC's mandate
    - FSOC to assign a primary regulator on issues as to which multiple agencies may have jurisdictions; and
  - Reforming the Office of Financial Research ("OFR") and making OFR part of the Treasury

Tailoring of Bank Capital and Liquidity Rules

- The report suggests better tailoring of capital and liquidity rules based on an institution's size and complexity and focuses principally on the enhanced prudential standards ("EPS") requirements under Dodd-Frank. Specifically, the report recommends:
  - DFAST requirements be raised to apply to institutions with total consolidated assets of $50 billion (instead of $10 billion);
  - The mid-year DFAST be eliminated and the scenarios simplified; and
  - The threshold for the application of the EPS be reevaluated and tailored based on an entity's risk profile

CCAR

- The report suggests significant changes to the CCAR, including
  - Increasing the threshold for the institutions that are subject to CCAR
  - Modifying the Federal Reserve's assessment approach
  - Changing CCAR to a two-year cycle
  - Requiring that the banking agencies provide greater transparency into the models and scenarios used and subjecting the framework to public notice and comment
  - Reassessing the CCAR assumptions

Liquidity Coverage Ratio (LCR)

Final Rule adopted September 2014

- Covered organizations must maintain high-quality liquid assets ("HQLA") equal to estimated net cash outflows over a 30-day stressed liquidity period
- Applies to Advanced Approaches organizations and any subsidiary bank with $10BB+
- Simpler modified version applies to others ("modified companies") with $50BB+ and that do not have significant commercial or insurance operations
- Full LCR applies to: advanced approaches banks ($250b in total consolidated assets or $10b or greater in on-balance sheet foreign exposures); other institutions made subject to LCR
- LCR Light (Modified LCR): depository institutions with $50b or less in total consolidated assets that are not: grandfathered SLHCs deriving 50% or greater of total assets or revenues from activities not financial in nature; insurance underwriting companies; or holding 25% or greater of total assets in insurance underwriting subsidiaries. Monthly (instead of daily) LCR calculations.

- LCR requires HQLA stock to be at least 100% of its total net cash outflows over a 30-day standardized liquidity stress scenario, plus a maturity mismatch add-on that includes only certain inflows/outflows likely to cause a maturity mismatch

$$\frac{\textbf{High-Quality Liquid Assets}}{\textbf{Total Net Cash Outflows}}$$

- HQLAs are categorized as Level 1, Level 2A, and Level 2B
  - No limit on Level 1 assets
  - Level 2 assets are capped at 40% of HQLAs; Level 2B assets are capped at 15% of total HQLAs
- **Level 1 assets** are not subject to haircuts. These include: excess reserves held at Fed, U.S. Treasuries, securities issued or guaranteed by full faith and credit of U.S. government, etc.
- **Level 2A assets** are subject to a 15% haircut. These include agency securities and claims on or guaranteed by a sovereign entity or multilateral development bank
- **Level 2B assets** are subject to a 50% haircut. These include certain corporate debt securities issued by non-financial companies; certain publicly traded equities of non-financial companies included in Russell 1000 Index or foreign equivalent

LCR, cont'd.

Liquidity Coverage Ratio

- The report suggests that the scope of the LCR be narrowed and made applicable to G-SIBs, with a less stringent standard be applied to internationally active BHCs that are not G-SIBs
- The report suggests that high-grade municipal bonds should be included as Level 2B HQLA
- The report also suggests that the banking agencies consider the effect of the current HQLA standards on the market for securitizations
- Finally, the report suggests reviewing the net cash outflows calculations incorporated in the LCR

Countercyclical Capital Buffer

- On September 8, 2016, the Federal Reserve Board adopted a final policy statement detailing the framework the Board will follow in setting the Countercyclical Capital Buffer ("CCyB")
- CCyB is applicable to Advanced Approaches Institutions
- CCyB is weighted based on a banking organization's particular composition of
  private-sector credit exposures across national jurisdictions
- CCyB is intended to function as an extension of the Capital Conservation Buffer
- The FRB voted to set the CCyB amount at zero percent; once fully phased in, the CCyB, will range from zero percent of RWAs to 2.5 percent
- Goal of the CCyB is to augment the resiliency of large banking organizations when there is an elevated risk of above-normal losses

- Above-normal losses frequently follow periods of rapid asset price appreciation or credit growth ("bubbles")
- CCyB is intended to increase during times of stress on the financial system and reduce when vulnerabilities of the stability of the financial system subside
- FRB, working with OCC/FDIC, will set the CCyB
- CCyB will fluctuate for each Advanced Approaches Institution
- The report suggests that CCyB be eliminated and that any countercyclical capital requirements be implemented through the operation of the CCAR/DFAST process

Countercyclical Capital Buffer, cont'd.

Supplementary Leverage Ratio (SLR)

- Finalized in September 2014; reporting began January 2015; compliance by January 2018
- Under the final capital rules adopted in 2013, banking organizations with total consolidated assets of at least $250 billion or $10 billion in total on-balance sheet foreign exposures are required to maintain an SLR of 3%.
- Bank holding companies with total consolidated assets of $700 billion or greater (Covered BHCs) and their insured depository institution subsidiaries are subject to an enhanced SLR of 2%, for a total SLR of 5%.
- Based on total leverage exposure that includes selected off-balance sheet exposures
- The final rule also requires an SLR of 6% for insured depository institution to be considered well capitalized
- Tier 1 capital is to be calculated as of the last day of each reporting quarter
- The total leverage exposure is to be calculated as the daily average of each reporting quarter for on-balance assets and the month-end average of each reporting quarter for off-balance sheet assets

- Report is highly critical of the SLR noting its impact on market liquidity and on critical banking functions, while noting that the SLR could indirectly encourage risk taking
- As with other Basel measures (i.e., LCR, G-SIB surcharge, etc.) the report suggests that the United States reform from "gold plating" and not impose standards that are more rigorous than those required by Basel

Supplementary Leverage Ratio (SLR), cont'd.

G-SIB Surcharge

- Added to Capital Conservation Buffer
- CET1
- Higher of two calculations
  - Method 1 – systematic risk score
  - Method 2 – systematic risk score
    - Minus substitutability score
    - Plus short-term wholesale funding score
- 0% to 5.5+%
- Surcharges are based on bands of scores
- Calculated annually
- Primary rationale
  - Mitigate risk of harm from failure of a G-SIB by reducing the likelihood of failure
- Secondary rationale
  - Create incentive to shrink systemic footprint
  - Offset any funding advantage from "too big to fail"
- Four-year phase-in: 25% each year, January 1, 2016, through January 1, 2019

Method 2

- Substitutes short-term wholesale funding for substitutability
- Score = Amount of G-SIB's systemic indicator x the following coefficients:
  - Size
    - Total exposures.....4.423%
  - Interconnectedness
    - Intra-financial system assets.....12.007%
    - Intra-financial system liabilities.....12.490%
    - Securities outstanding.....9.056%
- Complexity
  - Notional amount of over-the-counter (OTC) derivatives.....0.155%
  - Trading and available-for-sale (AFS) securities.....30.169%
  - Level 3 assets.....161.177%

- Cross-jurisdictional activity
  - Cross-jurisdictional claims.....9.277%
  - Cross-jurisdictional liabilities.....9.926%
- Short-Term Wholesale Funding Score = (Average weighted short-term funding amount ÷ Average G-SIB's average risk weighted assets) x 350
  - Short-term wholesale funding based on LCR concepts and 1-year maturity

Method 2, cont'd.

G-SIB Surcharge

- Consistent with the views expressed on other Basel measures, the report recommends that the banking agencies modify the Method 2 calculation in the G-SIB surcharge

Other Basel-Related Recommendations

- The report recommends
  - The U.S. banking agencies delay implementation of the Fundamental Review of the Trading Book rules in order to allow for a more complete assessment
  - Establishment of global risk-based capital floors
  - Recalculating the minimum long-term debt ratios that are included in the Federal Reserve's final TLAC rule so that these are not more punitive than the FSB final TLAC requirements

Improving the Regulatory Engagement Mode

- The report suggests re-evaluating the requirements imposed on the boards of directors of depository institutions
- According to the report, banking agencies should be subject to a uniform and more rigorous cost-benefit analysis requirement in order to improve the rulemaking process
- The report recommends an interagency assessment of the approach to identifying matters requiring attention, matters requiring immediate attention, and consent orders in order to achieve more consistency and transparency

Living Will Requirements

- The report suggests raising the threshold for living will requirements from $50 billion in total consolidated assets to match the revised threshold for EPS, making the process subject to a two-year cycle, and improving the guidance provided by regulators in response to living will submissions
- The FDIC should be eliminated from the living will process, according to the report, and the Federal Reserve should be required to review and provide feedback within six months

Foreign Banking Organizations

- The report recommends reassessing the regulations applicable to foreign banks so that these institutions are not unduly contained
- The report reviews various requirements applicable to foreign banking organizations, including the EPS requirements, the living will requirements, the intermediate holding company (IHC) requirement, and the capital and other requirements applicable to IHCs. The report suggests that:
  - EPS and living will requirements be based on a foreign bank's U.S. risk profile and not on the entity's global consolidated assets;
  - Threshold for IHCs to comply with U.S. CCAR requirements be raised consistent with the higher threshold recommended for U.S. BHCs;
  - The living will and other requirements applicable to IHCs be reevaluated and where home country requirements are sufficiently comparable, foreign banks should be allowed to meet U.S. requirements by meeting their home country standards; and
  - Other requirements applicable to IHCs, such as the internal TLAC requirement, be recalibrated

Volcker Rule

- The report recommends exempting smaller institutions (banks with $10 billion or less in total consolidated assets) from all aspects of the Volcker Rule
  - Banks with over $10 billion in total consolidated assets that have limited trading assets and liabilities would be exempt from the proprietary trading restrictions of the rule (but subject to the covered funds provisions of the rule)
- The report notes the need for better coordination among the agencies charged with oversight for Volcker Rule compliance
- The report would simplify the definition of "proprietary trading" by eliminating the "purpose test" and eliminating the rebuttable presumption of proprietary trading in respect of financial instruments held for fewer than 60 days
- The report notes the negative effect of the rule on market-making activity and suggests that regulators give banks additional flexibility to adjust their determinations of the reasonable amount of inventory

- The report raises other possible approaches to modifying the reasonably expected near-term demand (RENTD) requirement
- The compliance and recordkeeping burdens associated with hedging activities
- The report makes a number of suggestions that are intended to simplify the covered fund restrictions, as well as reduce the burdens associated with the compliance program requirements
  - All of the suggestions regarding the rule are qualified by a final recommendation that consideration be given to implementing an "off-ramp" approach by which banks that are sufficiently well-capitalized, such that they can address risks posed by proprietary trading, would cease to be subject to the rule's prohibitions

Volcker Rule, cont'd.

Leveraged Lending

- The report cites a number of shortcomings with the banking agencies' leveraged lending guidance and notes that the guidance leaves ambiguity regarding the definition of "leveraged lending"
- The report explains that the guidance lacked clear penalties for noncompliance
- The report recommends that the guidance be re-issued for public comment
- Following the comment period, the guidance should be refined with a view toward avoiding ambiguity and achieving consistency in supervision, examination, and enforcement
- Banks also should be encouraged, according to the report, to incorporate a clear and robust set of metrics when underwriting a leveraged loan rather than relying solely on a 6x leverage ratio discussed in the existing guidance

Small Business Lending

- The report notes a number of impediments to small business lending and, in order to promote small business lending, the report recommends:
  - Changes to the regulatory framework for community banks and credit unions, which institutions are critical to small business lending;
  - Changes to the leveraged lending guidance, which should result in improved access to capital for small and medium-sized businesses;
  - Changes to banking agency guidance relating to commercial real estate lending;
  - Addressing the calibration of the SLR for working capital loans and unfunded lines of credit to small businesses; and
  - Repealing Section 1071 of the Dodd-Frank Act, which requires that the CFPB establish regulations and issue guidance for small business loan collection