U.S. Treasury Department Releases Report to Reform U.S. Financial System

On June 12, 2017, just days after the House of Representatives passed the Financial CHOICE Act (CHOICE Act), a bill to repeal and replace many of the banking reforms implemented by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the U.S. Treasury Department (Treasury) released its long-awaited report to reform the U.S. financial system. The report is entitled “A Financial System That Creates Economic Opportunities: Banks and Credit Unions” (Report). It includes dozens of recommendations to reform “laws, treaties, regulations, guidance, reporting and record keeping requirements, and other Government policies” that inhibit federal regulation of the U.S. financial system in a manner consistent with the set of Core Principles enunciated by President Trump in Executive Order 13772, issued on February 3, 2017.

It is noteworthy that, in most cases, the Report’s recommendations are more modest than the CHOICE Act’s, and that many of the Report’s recommendations only require action by the federal financial regulatory agencies. This seems to be an acknowledgement that legislative change will be very challenging while regulatory action will be more achievable. President Trump and the Republican Senate will have the opportunity to reshape the leadership at the financial regulatory bodies. Even if the independent chairs served their full terms, every leader’s term expires during the current Congress. President Trump will nominate and the Republican Senate will confirm their replacements. Nonetheless, if the changes recommended by the Report were implemented in full or in large part, they would represent a significant overhaul of the post-Dodd-Frank bank regulatory framework.

Even though enacting legislation to amend Dodd-Frank will be difficult, there may be room for compromise related to the oversight of midsized and regional banks. In comments after the Report’s release, both Sen. Mike Crapo (R-Idaho), chairman of the Senate Committee on Banking, Housing and Urban Affairs, and Sen. Sherrod Brown (D-Ohio), the committee’s ranking Democratic member, focused on better tailoring standards and rules. Sen. Crapo said he was “very encouraged” by the Report as it “includes reasonable and meaningful recommendations to the existing, and all too often, one-size-fits-all regulatory landscape.” Sen. Brown slammed “proposals to weaken oversight of the biggest banks,” but he expressed hope that “there is room for agreement on a modified regime for overseeing regional banks[,]” including related to stress tests and living wills.

For your convenience, a chart has been prepared that outlines the similarities and differences between the CHOICE Act and the Report. The Report is summarized below.
After setting forth a series of economic, markets and regulatory justifications for the reform recommendations to follow, the 147 page Report summarizes the Treasury’s “significant areas” for reforming the regulatory framework for the depository sector as:

- “addressing the U.S. regulatory structure”;
- “refining capital, liquidity, and leverage standards”;
- “providing credit to fund consumers and businesses to drive economic growth”;
- “improving market liquidity”;
- “allowing community banks and credit unions to thrive”;
- “advancing American interests and global competitiveness”;
- “improving the regulatory engagement model”;
- “enhancing use of regulatory cost-benefit analysis”; and
- “encouraging foreign investment in the U.S. banking system.”

As to reforms in regulatory structure, the Report provides specific recommendations for Congress to reduce regulatory fragmentation and overlap, mandate that the Financial Stability Oversight Council (FSOC) assign a lead regulator as a primary regulator where jurisdictions overlap, and reform the structure and mission of the Office of Financial Research (OFR) making it a non-independent agency of the Treasury. The Report also seeks harmonization of cyber security efforts by the federal and state financial regulatory agencies.

The Report next addresses capital and liquidity issues at banks and their holding companies. The Report requests that Congress and the federal financial regulatory agencies tailor Dodd-Frank Act Stress Test (DFAST), Comprehensive Capital Analysis and Review (CCAR), liquidity coverage ratio (LCR), single-counterparty credit limits (SCCL) stress-testing and enhanced prudential standards (EPS) to the larger institutions, reduce regulatory burdens and improve transparency, recalibrate the U.S. implementation of international regulatory standards affecting G-SIB risk-based charges and total loss-absorbing capacity (TLAC), and finalize the Basel Committee capital standards. The Report recommends less frequent stress-testing cycles, improved transparency of the testing process, and that the EPS be applied based on the complexity of the institution. It also suggests that Congress provide a “regulatory off-ramp” for banks that elect to be highly capitalized from the liquidity and capital requirements, and aspects of Dodd Frank’s EPS and Volcker Rule requirements.

The Report makes several recommendations targeted at easing consumer credit regulations. They include simplifying the capital regimes of community banks, raising the Federal Reserve’s asset threshold for small bank holding companies, offering community development financial institution (CDFI) and minority depository institution (MDI) banks greater flexibility with their capital structure, easing stress-testing and capital regulations on national credit unions and increasing the dollar threshold for when stress-testing applies to credit unions. The Report also proposes a number of changes that would reduce the reporting, examination and de novo banking application process requirements for this class of banks.

As to the regulatory engagement model, the Report seeks to address a number of the frequent and virtually unanimous complaints that bank management and boards of directors have made over the years.
Importantly, it recommends a review of the extent to which the regulatory framework and requirements have created an imbalance in the relationship between the regulators, the banks’ boards of directors and bank management. For example, in response to concerns about regulatory and compliance requirements diverting bank board of directors’ attention from their principal roles of governance, oversight and strategy, the Report emphasizes cost-benefit analyses with respect to proposed regulations and a review of the volume and nature of matters requiring attention and matters requiring immediate attention (MRAs and MRIAs) and consent orders to avoid overlap and inconsistency among agencies. Finally, the Report recommends a comprehensive assessment of the supervisory and regulatory framework of the Community Reinvestment Act (CRA) and better alignment of the regulatory oversight of CRA activities with community investments. The Report indicates this CRA review is a “high priority” for the Secretary.

Consistent with other recommendations, the Report suggests raising the threshold for the living wills requirement in Dodd-Frank to match the revised threshold for EPS, changing the living will process to a two-year cycle and improving the guidance that is provided by the regulators for the submission and assessment of the living wills. Significantly, the Report would remove the Federal Deposit Insurance Corporation (FDIC) from the living will process altogether and impose a time limit of six months on the Federal Reserve to review and provide feedback to banks on their living wills.

For foreign banking organizations (FBOs), the Report would also recommend revising the thresholds for EPS and living wills requirements to be based on an FBO’s U.S. risk profile and not its global consolidated assets. It would also recommend raising the threshold for intermediate holding companies (IHCs) to comply with U.S. CCAR and recalibrating other IHC regulatory standards, including resolution planning, liquidity and TLAC.

Rather than repeal the Volcker Rule in its entirety, the Report would exempt banks with $10 billion or less in assets and exempt banks with greater than $10 billion in assets from the proprietary trading prohibitions of the Volcker rule if they are not subject to market the risk capital rules. The Report asks agencies to coordinate their guidance and enforcement of the Volcker rule, eliminate the 60-day rebuttable presumption from the definition of propriety trading, consider eliminating the purpose test from that definition, provide flexibility for market making, reduce the burden of hedging risk under the Volcker Rule, reduce the burden of Volcker rule compliance regimes, simplify the covered funds restrictions, and create an “off-ramp” for well-capitalized banks.

The Report would subject the director of the Consumer Financial Protection Bureau (CPFB) to at-will removal by the President or a restructuring of the entire agency as an independent multi-member commission. The agency would be funded by Congressional appropriation rather than through the Federal Reserve and subject to Office of Management and Budget (OMB) apportionment. The Report recommends a number of actions that would limit the CFPBs mandate and its enforcement role.

Finally, the Report cites a number of recommendations for reformation of the mortgage loan origination, mortgage serving and private sector mortgage market-making activities. It also recommends the reissuance of the regulators’ leveraged lending guidance for public comment and various simplifications of the small-business lending process.
If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work or

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