REGULATORY INTELLIGENCE BRIEFING — ISSUE 6, 2018

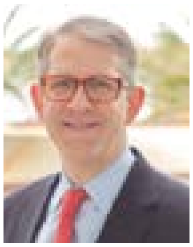
MIDYEAR REGULATORY CHANGE REVIEW

Capco Center of Regulatory Intelligence

CAPCO

IN THIS ISSUE

EDITORIAL NOTE FROM THE MANAGING PRINCIPAL, CENTER OF REGULATORY INTELLIGENCE



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Peter has more than 16 years of government and consulting experience in advising clients on supervisory matters before the U.S. government and in the implementation of enterprise risk management programs. He is a thought leader in government affairs and regulatory strategies in support of banks' and financial institutions' compliance with the Dodd-Frank Act and Basel Accords. Prior to joining Capco, he served as a director of government relations at Clark Hill and in senior government positions, including serving as a deputy assistant secretary at the United States Department of the Treasury.

When President Donald Trump took office, he vowed that his administration would bring major reforms to the financial services industry, and one year ago, when the Department of the Treasury (Treasury) put out *A Financial System That Creates Economic Opportunity — Banks and Credit Unions*, we saw our first glance into what these changes would be. In the last year, and particularly in the last six months, there have been significant changes through rulemaking, legislative shifts and agency direction, among other catalytic avenues.

With the first half of 2018 behind us, our focus article for this month's Regulatory Intelligence Briefing (RIB) reviews recent developments, comparing the change we have seen to what was outlined, and identifying which changes may lie ahead. We analyze some of the major effects of the recently passed reform package, the Economic Growth, Regulatory Relief, and Consumer Protection Act, as well as discuss the implications of certain proposed rules, such as the joint proposal amending the Volcker Rule.

Our Congressional Activity Summary looks at the Customer Due Diligence Rule that has now been in effect for two months. Some institutions are discovering new compliance issues related to certain aspects of the Rule, and in this article, we answer several of the major questions we've received from clients. We also take a look at proposed bills that could alter the rule — while these are still pending, the potential modifications bring to light some of the areas that could still see change.

As the regulatory landscape continues to shift, Capco Center of Regulatory Intelligence (CRI) continues to monitor and analyze, keeping your institution proactively informed. Both our articles this month deliver up-to-date, actionable knowledge to ensure current and future compliance. As always, please reach out to let us know your areas of concern, and consider joining us for our webinar and seminar series confronting a broad range of risk and compliance concerns. ❖

REGULATORY ROUNDUP

Regulatory and Compliance Alerts

FinCEN Issues Updated Advisory on Human Rights Abuses

On June 12, 2018, the Financial Crimes Enforcement Network (FinCEN) issued an updated advisory to U.S. financial institutions to highlight the connection between corrupt senior foreign political figures and how they enable human rights abuses.

Agencies Release List of Distressed or Underserved Nonmetropolitan Middle-income Geographies

On June 25, 2018, the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) announced the availability of the 2018 list of distressed or underserved nonmetropolitan middle-income geographies, where revitalization or stabilization activities are eligible to receive Community Reinvestment Act consideration under the community development definition. This information is on the Federal Financial Institutions Examination Council's (FFIEC) website.

NCUA Announces Final Rule on Member Business Lending and One- to Four-unit Properties

On June 1, 2018, the National Credit Union Administration (NCUA) Board announced a final rule with a provision that federal credit unions no longer have to count loans made on any one- to four-unit family dwellings as member business loans. **The rule became effective June 5, 2018.**

CFPB Issues Quarterly Report on Consumer Credit Trends

On June 7, 2018, the Consumer Financial Protection Bureau (CFPB) released the latest quarterly consumer credit trends report, which focuses on end-of-year credit card borrowing and credit card balance repayment in the new year.

HUD Issues ANPR on Fair Housing Act's Disparate Impact Standard

On June 20, 2018, Department of Housing and Urban Development (HUD) issued an advance notice of proposed rulemaking (ANPR) seeking comment on whether its 2013 Disparate Impact Rule should be revised in light of the 2015 U.S. Supreme Court ruling in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.* **Comments are due by August 20, 2018.**

FRB Approves Rule on Single-Counterparty Credit Limits

On June 14, 2018, the FRB approved a rule to prevent concentrations of risk between large banking organizations and their counterparties from undermining financial stability. **The rule becomes effective 60 days after publication in the Federal Register, with compliance dates of January 1, 2020, and July 1, 2020.**

CONGRESSIONAL ACTIVITY SUMMARY:

CUSTOMER DUE DILIGENCE COMPLIANCE

It has now been two months since the Financial Crime Enforcement Network's (FinCEN) Customer Due Diligence (CDD) Rule compliance deadline on May 11, 2018. Capco has received many questions since then, and it appears some institutions are still struggling in certain areas.

Preparing for Compliance

To prepare financial institutions for compliance, FinCEN provided the following guidance:

- A summary of the rule's requirements
- An explanation of which financial institutions are covered by the rule
- A description of the identification information to be obtained from legal entity customers at account opening
- The mechanism for collecting and verifying the identity of beneficial owners
- Frequently Asked Questions (FAQs)
- The required policies and procedures financial institutions must implement to obtain information on beneficial owners and to conduct ongoing customer due diligence
- Information regarding how financial institutions must use the collected information

How FinCEN Plans to Enforce the Rule

On May 16, 2018, five days after the deadline, FinCEN Director Kenneth Blanco addressed the House Financial Services Committee and discussed the CDD Rule. Specifically, two quotes caught Capco Center of Regulatory Intelligence's (CRI) attention:

"Although we expect covered institutions to be ready on May 11, 2018, to begin timely and effective implementation of the policies, procedures, and controls required under the CDD Rule — and we are pleased to have heard from many in industry that they were ready — we also understand that institutions, regulators and other stakeholders may need a little extra time to smooth out any wrinkles. This is the case whenever we issue a new rule, the purpose of which is always to enhance our [anti-money laundering (AML)] regime and not to serve as a vehicle for punishing financial institutions."

"Our goal in this rule is to gain the transparency needed to protect the U.S. financial system and to prevent, deter, detect and disrupt money laundering, terrorist financing and other serious crimes. It is important for us to continue to work with our regulatory partners, their examiners and financial institutions to achieve these objectives through compliance with the rule. It is equally important, however, to understand that seamless implementation does not happen overnight and, for some areas, we all will need time to benefit from cumulative practical experiences with the new rule as part of the process. In the meantime, we would encourage financial institutions to alert their examiners to any issues early on, and to share such concerns with FinCEN."

It appears FinCEN is attempting to be transparent with regulators and making real efforts to implement the CDD rule, rather than jump into heavy enforcement actions against financial institutions that are non-compliant.

learning opportunity

On August 30, 2018, Capco Academy will be hosting a "CDD: Beyond the Basics" webinar. Facilitators will address the problems our clients are facing in this area, including issues this article outlines, among other hot topics. Find out more and register here.

Where Financial Institutions are Struggling

Rollover and Rollback Accounts

This has, perhaps, been the area FinCEN addressed most expediently. On May 16, FinCEN issued an administrative ruling providing a 90-day limited exceptive relief for legal entity customers of certain financial products and services for matters related to automatic rollovers or renewals. The administrative ruling clarifies that each time a loan is renewed or a certificate of deposit is rolled over, the bank establishes another formal banking relationship, creating a new account. Therefore, a bank is required to obtain information on the beneficial owners of a legal entity that opens a new account, even if the legal entity is an existing customer. The April FAQs spell out this scenario in more detail (see Question 12).

Nonprofits

Nonprofits are excluded from the CDD Rule's ownership prong, but not from the control prong. The preamble to the 2016 regulations at 81 F.R. 29416, states: "...FinCEN has determined that it would be simpler, as well as more efficient and more logical, to exclude all nonprofit entities (whether or not tax-exempt) from the ownership prong of the requirement, particularly considering the fact that nonprofit entities do not have ownership interests, and require only that they identify an individual with significant responsibility to control, manage, or direct the customer."

Condo Associations

Particularly, Capco has received questions on the treatment of unincorporated associations like condo associations. In the 2018 FAQs, Question 22 addresses this situation. The answer is that sole proprietorships, either individual or spousal, and unincorporated associations are not "legal entity customers" under the CDD rule, even though the business may file with the Secretary of State so it can register a trade name or establish a tax account. This is because neither a sole proprietorship nor an unincorporated association is a "separate legal entity" from the associated individual(s), and therefore beneficial ownership is not inherently obscured. Of particular importance is the phrase "separate legal entity," which appears to play an important role in this determination, and likely excludes most condo associations from beneficial ownership requirements.

Third Parties

Third parties provide an interesting conversation for banks under the beneficial ownership lens. Simply put, because there is no account (deposit or loan) being opened at the covered financial institution, the beneficial ownership rule does not likely apply to vendors, partner merchants and service providers (assuming no exceptions apply). But, financial institutions should address this in their vendor management policies and procedures, and ensure that applicable third parties comply with the provisions.

314(a) Searches

While banks are not technically required to search beneficial owners against the 314(a) list, many AML systems may not have the current ability to segregate beneficial owners against 314(a). It is unknown whether a bank would be faulted for searching their beneficial owners against 314(a), but if a legitimate match occurs, a bank should notate in the alert/report that the record is a beneficial owner. Among others, this is also one area Capco believes FinCEN could address in future guidance.

Moving Forward

In analyzing Blanco's statements and looking at the legislative activity in Congress, it seems additional changes could be in store for the CDD Rule. While this may not happen in 2018 due to the upcoming midterm elections, there is current proposed legislation that outline some of the potential alterations to the rule. All bills were pending in their house of origin at the time of writing.

Bill Number	Title	Summary
H.R. 3089/ S. 1717	Corporate Transparency Act of 2017	Amends title 31 of the U.S.C. to ensure that persons who form corporations or limited liability companies in the U.S. disclose the beneficial owners of those corporations or limited liability companies, in order to prevent wrongdoers from exploiting U.S. corporations and limited liability companies for criminal gain, to assist law enforcement in detecting, preventing and punishing terrorism, money laundering and other misconduct involving U.S. corporations and limited liability companies, and for other purposes.
S. 1454	True Incorporation Transparency for Law Enforcement (TITLE) Act	Amends the Omnibus Crime Control and Safe Streets Act of 1968 to require a state that receives funding under the Edward Byrne Memorial Justice Assistance Grant program to implement certain incorporation practices, including a requirement for an entity that forms a corporation or limited liability company to provide information about its beneficial owners. The bill also imposes civil penalties and authorizes criminal penalties; broadens the term "financial institution"; and requires the Government Accountability Office (GAO) to study and report on beneficial ownership and other portions of the bill.
H.R. 3544	Aircraft Ownership Transparency Act of 2017	Requires the Federal Aviation Administration to obtain the identity of each beneficial owner of an entity seeking a certificate of registration for an aircraft.

Additionally, on June 26, GAO released a report finding a need for further action under the Bank Secrecy Act (BSA) to address domestic and international derisking concerns. While the outcomes and recommendations from the report are not as clear as in previous reports related to derisking, the report does still clarify that financial institutions are limiting what services are available to certain markets with correlation to BSA/AML enforcement.

Capco will continue to monitor this issue, and please feel free to reach out to us with any questions you have related to the CDD rule. ❖

FOCUS MIDYEAR REGULATORY CHANGE REVIEW

With half of 2018 behind us, Capco takes a look at some of the most pertinent regulatory changes that have occurred in the financial services industry this year. We use the Treasury report released in June 2017 on banks and credit unions as a blueprint to address what changes have been made so far and what changes could be on the horizon.

On June 12, 2017, the U.S. Department of the Treasury (Treasury) released a report titled *A Financial System That Creates Economic Opportunity – Banks and Credit Unions* (the Report) as the first of a series of reports it published in response to the February 3, 2017, Executive Order 13772, Presidential Executive Order on Core Principles for Regulating the United States Financial System. Since then, we've seen numerous changes and developments from legislators and regulators alike, including impactful aspects of tax reform and shifts in agency leadership and direction. Now halfway through 2018, we will review the areas that have seen change and utilize our regulatory intelligence (recent industry trends, news and legislative actions) to show what changes could potentially be coming.

In this article, we will update you on the areas of the Report which Capco focused on in our initial review, published in our August 2017 Regulatory Intelligence Briefing. These issues include:

- Common themes and general recommendations
- Community Reinvestment Act (CRA)
- Stress testing and standards for larger institutions
- Community financial institutions (with less than $10 billion in assets, including credit unions)
- The Volcker Rule
- The Consumer Financial Protection Bureau's (CFPB) structure and related areas
- Various lending areas (including private sector secondary markets, leveraged lending and small business lending)

The Treasury Report

The Treasury Report series (*A Financial System That Creates Economic Opportunity*) was intended to identify and provide recommendations for reform in any areas inconsistent with or inhibiting a financial system in line with President Donald Trump's Core Principles, as outlined in Executive Order 13772.

As Treasury's first response to Executive Order 13772, the banks and credit unions report covers issues regarding the depository system (Treasury also released two reports in October 2017 on Capital Markets and Asset Management and Insurance). The recommendations strive to enforce alignment with the Core Principles Trump outlined in his Executive Order. About two thirds of the Report's recommendations were regulatory in nature and the other third would require Congressional action. Though the Report is multifaceted and detailed, the mission was to identify "recommendations that can better align the financial system to serve consumers and businesses in order to support their economic objectives and drive economic growth."

The Report includes detailed recommendations on a variety of aspects of the U.S. depository system, but there are a few common trends throughout:

- 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
- Aligning regulations to support market liquidity, investment and lending in the U.S. economy

The Economic Growth, Regulatory Relief, and Consumer Protection Act

Perhaps the most impactful development in the first half of 2018 has been S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, which President Trump signed into law on May 24, 2018. The bill is broken into six sections:

I. Improving Consumer Access to Mortgage Credit
II. Regulatory Relief and Protecting Consumer Access to Credit
III. Protections for Veterans, Consumers and Homeowners
IV. Tailoring Regulations for Certain Bank Holding Companies
V. Encouraging Capital Formation
VI. Protections for Student Borrowers

Other Agency Announcements and Actions

A myriad of other events has influenced and signaled change this year. In each area we outline, we will discuss these factors, including additional legislation, agency announcements, leadership changes, legal proceedings and more.

COMMON THEMES AND GENERAL RECOMMENDATIONS

June 2017 Treasury Report Recommendations	Updates and Developments
FSOC: Broaden the statutory mandate for the Financial Stability Oversight Council (FSOC) so it can assign a lead regulator for issues arising in overlapping jurisdiction and reform FSOC to enhance information sharing and interagency coordination.	Developments at FSOC will likely play an important role in the financial services industry. In September 2017, Treasury Secretary and FSOC Chairman Steven Mnuchin presided over a meeting of the FSOC in which the fiscal year budget was approved, cutting funding by 15 percent. Perhaps more importantly, the budget reduces the target staffing from 36 full-time employees to only 18 — a 50 percent cut. Additionally, Mnuchin issued a report to Trump on FSOC systemically important financial institutions (SIFIs) and financial market utilities (FMUs) designations in November, outlining recommendations for change. On February 6, 2018, Mnuchin testified before the House Financial Services Committee with an FSOC report. He mentioned that FSOC would "in the near future, this year" discuss the designation of the last remaining nonbank SIFI. FSOC's removal of this designation would render the SIFI program — one of FSOC's central functions — effectually dormant, as there would be no nonbank SIFIs to regulate.
BOD REQUIREMENTS: Create an inter-agency review to assess and tailor the collective requirements for financial institutions' boards of directors (BODs) and restore balance in the relationship between regulators, boards and bank management.	While there have not been regulatory policy changes regarding requirements for BODs, this area has still been in the spotlight following atypical enforcement actions against large banks, citing deficiencies in corporate governance structures.
CYBERSECURITY: All regulatory agencies establish processes for coordinating tools across sub-sectors, including a common lexicon and uniform understanding and implementation of cybersecurity rules and guidelines.	Cybersecurity has been a top priority for regulators and legislators both at the federal and state levels. S. 2155 provides that Treasury submit a report to Congress on the risks of cyber threats to financial institutions and capital markets in the U.S. Additionally, the IRS announced that cybersecurity will be a main focus of their Nationwide Tax Forums during Summer 2018. On June 21, 2018, the Office of Management Budget (OMB) released a plan for government reform and reorganization, with a section titled "Solving the Cybersecurity Workforce Shortage." OMB's efforts in the space are in coordination with the Department of Homeland Security (DHS), which released its own report on cybersecurity strategy on May 15, 2018.

June 2017 Treasury Report Recommendations	Updates and Developments
INTERAGENCY COORDINATION, INCLUDING ENFORCEMENT STANDARDS: Take action to reduce fragmentation, overlap and duplication in the U.S. regulatory structure; conduct interagency reassessment of matters requiring attention (MRAs), matters requiring immediate attention (MRIAs) and consent orders (COs), to evaluate impact and establish standards for improved regulatory action assessment and clearing.	On June 12, 2018, the Federal Financial Institutions Examination Council (FFIEC) rescinded a 1997 policy statement, which the three main banking agencies immediately replaced. The replacement policy that the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC) issued continues the agencies' longstanding practice of notifying one another when issuing enforcement actions against financial institutions another agency may also be interested in pursuing. In the FFIEC's rescission statement, the council explained its belief that the 1997 policy was out of date: "[The policy] was created at a time when electronic communication was much less common than it is today." The new policy deviates from the 1997 version in several ways: the policy previously included state supervisory authorities and affected all five of the FFIEC member regulators (the FRB, the OCC, the FDIC, the National Credit Union Association (NCUA) and the CFPB). The new policy only covers the first three. It is interesting to note that H.R. 10 (Financial CHOICE Act), which is the House's financial services regulatory relief package that has not passed, would require eight agencies (the FRB, CFPB, FDIC, OCC, the Commodity Futures Trading Commission (CFTC), the Federal Housing Finance Agency (FHFA) and the Securities and Exchange Commission (SEC)) to "minimize duplication" of enforcement actions against financial institutions. The agencies would be required to establish when joint investigations and actions would be in the public interest, and procedures for deciding upon a "lead agency" in these situations to avoid duplication of efforts and "ensure consistent enforcement." While S. 2155 does not include a section on interagency enforcement coordination, heavier enforcement coordination legislation may be forthcoming, particularly as minimizing duplicative efforts and resources ties into the Trump administration's goal of deregulation.

COMMUNITY REINVESTMENT ACT

The Treasury report gave a short but comprehensive analysis of a highly probable Treasury reassessment of the Community Reinvestment Act (CRA) and its regulatory framework, to ensure the benefits from such investments align with the interests and needs of the communities they serve. The report noted that while all three prudential regulators (FDIC, OCC and FRB) check for CRA compliance, none is ultimately responsible for evaluating whether the Act achieves its goals.

Upon Treasury's request, on February 2018, the Government Accountability Office (GAO) released a report related to CRA modernization efforts, titled "Options for Treasury to Consider to Encourage Services and Small-Dollar Loans When Reviewing Framework." In April, Treasury released its own memo focusing on regulatory and administrative changes, including reforms to reduce the complexity and burden on banks, regulators and community advocates.

On June 13, 2018, Comptroller of the Currency Joseph Otting testified before the House Financial Services Committee and discussed CRA modernization. Otting stated that the agencies are discussing an Advanced Notice of Proposed Rulemaking (ANPR) to explore best options for modernizing CRA regulations. Otting supports a new CRA framework that would:

1. Expand the types of activities that qualify for CRA consideration (such as including small business lending and opportunities for consumers to access short-term, small dollar loans);

2. Revisit the concept of assessment areas to broaden it beyond branches and deposit-taking ATMs; and

3. Use a metrics-driven approach to evaluating CRA performance to increase public transparency and reduce subjectivity in examiner ratings.

Two days later, on June 15, the OCC issued a bulletin related to CRA performance evaluations, providing clarifications to OCC's supervisory CRA policies and process. This statement came after the OCC rescinded its previous "Large Bank CRA Examiner Guidance" on June 1, 2018, which had been in effect since December 2000 (OCC Bulletin 2000-35). The changes to the CRA supervisory policies outlined in the bulletin were effective immediately. The policy clarifications include, but are not limited to:

- Implementation of full-scope and limited-scope reviews
- Consideration of activities that promote economic development
- Use of demographic, aggregate and market share data
- Evaluation of the borrower distribution of loans outside bank assessment areas
- Evaluation frequency and timing
- The CRA performance evaluation period
- Evaluation of home mortgage loans

The OCC communicated to examiners the clarifications to standard processes related to CRA evaluations, which took effect on May 2, 2017. This includes but is not limited to:

- The type of information considered and presented in the written performance evaluation and the process for sharing CRA evaluation data and ratings with OCC-supervised banks
- Factors considered when evaluating bank performance under the small- and large-bank lending tests
- Branch distribution when concluding on the availability and effectiveness of bank systems for delivering retail banking services
- Internal and external performance context factors when concluding on performance
- Consideration of CRA plans imposed as conditions of approval of corporate applications in the evaluation process.

But, as Otting stated, the OCC may not be the only federal banking regulator to issue changes to the CRA. Following the GAO and Treasury reports, and after discussion of an ANPR, the other two regulators (FDIC and FRB) may soon announce their own actions surrounding CRA modernization, and it is an area in which we are likely to see more developments in the near future.

STRESS TESTING AND ENHANCED PRUDENTIAL STANDARDS FOR LARGE BANKS

The Treasury Report found stress testing such as Dodd-Frank Act stress testing (DFAST) and enhanced prudential standards (such as contingent capital, resolution plans, credit exposure reports, single-counterparty credit limits, enhanced public disclosures and short-term debt limits) to be burdensome, opaque and too broad. S. 2155 made several changes to these tests and standards for bank holding companies (BHCs), with the central changes following Treasury's recommendations to raise asset thresholds at which certain requirements apply.

Additionally, S.2155 directs FDIC, FRB and OCC to classify qualifying investment-grade, liquid and readily-marketable municipal securities as level 2B liquid assets under the agencies' Liquidity Coverage Ratio final rule.

On June 14, 2018, the FRB unanimously voted to pass the final rule to establish single-counterparty credit limits (SCCL) for covered large U.S. BHCs and foreign banking organizations (FBOs). The final rule represents application of S. 2155's enhanced prudential standards.

BHCs $10 billion to $50 billion

- No longer subject to mandatory Dodd-Frank Act stress testing (DFAST)
- No longer required to have a risk committee (S. 2155 allows but does not require the FRB to impose the risk committee requirement on publicly held banks with total assets less than $50 billion. Therefore, the pre-existing regulatory requirement for publicly traded remains effective but the FRB could eliminate it.)

BHCs $50 billion to $100 billion

- On enactment date, exempt from the Dodd-Frank enhanced prudential standards

BHCs $100 billion to $250 billion

- Eighteen months after date of enactment, exempt from the Dodd-Frank enhanced prudential standards, other than stress testing
- FRB will have discretionary authority to apply the standards to these banks

Of note in this year's DFAST and Comprehensive Capital Analysis and Review (CCAR) testing was that the FRB excluded three firms below the $100 billion asset threshold, in response to provisions from S. 2155.

2018 TEST RESULTS

On June 21, 2018, the FRB released its 2018 DFAST results. While all firms exceeded minimum required capital under stress for the fourth year in a row, the stress impact this year was higher than in previous years, which resulted in lower post-stress minimum capital levels and reversed an improving trend. For most firms, post-stress supplemental leverage ratios were closer to minimum levels than last year and all firms exceeded the minimum ratio of 3 percent.

On June 28, 2018, FRB released the results of its CCAR tests, announcing the agency did not object to the capital plans of 34 firms and did object to the capital plan of one firm. Two firms will maintain their capital distributions at the levels they paid in recent years, somewhat due to changes in S. 2155 that negatively affected capital levels. Another firm will be required to review and amend how it manages and analyzes counterparty exposures under stress.

RECOMMENDED STANDARDS FOR COMMUNITY FINANCIAL INSTITUTIONS

The Treasury Report took a strong stance on community financial institutions (those with less than $10 billion in assets) as well, recommending an approach of tailoring requirements to eliminate one-size-fits-all regulation. One of Treasury's goals in adopting change is to reverse the current trending decrease in the number of smaller financial institutions (under $100 million in assets) and credit unions and encourage de novo activity.

This was also a main focus of S. 2155 and the table below shows what the Treasury report recommended versus what has been adopted through the Act.

June 2017 Treasury Report Recommendations	Passed Legislation through S. 2155
COLLINS AMENDMENT: Exempting banks with less than $10 billion in assets from Basel III standards and Dodd-Frank's Collins Amendment (Dodd-Frank section 171)	Requires federal banking agencies to establish a leverage ratio for banks with less than $10 billion in assets (tangible equity to average consolidated assets) at a rate between 8 percent and 10 percent, to replace the general applicable risk-based capital requirements for all banking organizations under the Basel III capital rules
MSAs and HVCRE: Amending and clarifying requirements for and definitions of mortgage servicing assets (MSAs) and High Volatility Commercial Real Estate (HVCRE)	Prohibits federal banking agencies from requiring a depository institution to assign a heightened risk weight to an HVCRE exposure under any risk-based capital requirement unless the exposure is an "HVCRE ADC" loan, as the statute defines. Under the BASEL III capital rules, institutions are required to report all HVCRE loans separately from commercial real estate loans and to assign a risk weighting of 150 percent for risk-based capital purposes (previously 100 percent).
SMALL BANK HOLDING COMPANY POLICY STATEMENT: Raising the Small Bank Holding Company Policy Statement asset threshold from $1 to $2 billion	Raises the asset threshold under the Small Bank Holding Company Policy Statement from $1 billion to $3 billion. Qualifying Institutions are not subject to consolidated capital requirements at the holding company level; instead, regulatory capital ratios only apply at the subsidiary bank level, which allows small bank holding companies to use non-equity funding, such as holding company loans or subordinated debt, to finance growth.

With regards to changes for community banks, S. 2155 additionally:

- Raises the asset threshold for 18-month examination cycle eligibility (versus a 12-month cycle) from $1 billion to $3 billion. Generally, regulators must conduct on-site examinations at least once in each 12-month period. However, if a bank below the threshold meets certain criteria, regulators may examine the bank only once every 18 months. Raising this threshold allows more banks to be subject to less frequent examination.
- Requires regulators to issue regulations that allow for reduced reporting requirements for the Q1 and Q3 reports filed by depository institutions with total consolidated assets of less than $5 billion

Credit Unions

Proposed Risk-based Capital Rule: NCUA's risk-based capital rule, which operates similarly to the Basel III rules for banks, is set to become effective in 2019 for federally-insured credit unions with at least $100 million in assets. Treasury suggested revising this rule, and on June 26, 2018, the House passed H.R. 5841 (Foreign Investment Risk Review Modernization Act of 2018), which includes amendments to delay the risk-based capital rule's effective date by two years, pushing it to 2021.

Stress Testing: On April 19, 2018, at their fourth board meeting for the year, the NCUA approved a rule under which credit unions with less than $20 billion in assets will still be required to develop annual capital plans, but will no longer have to submit those plans to the NCUA annually. Those above the $20 billion mark will still have to submit those plans. Additionally, the rule removes the requirement for NCUA supervisory stress testing, instead requiring credit unions subject to the rule to conduct those tests themselves. The NCUA still reserves the right to conduct a stress test if they deem it is necessary. Credit unions with less than $15 billion in assets will no longer be required to conduct stress testing. Those above the $15 billion mark will be required, and those above $20 billion will be subject to a 5 percent minimum stress test capital ratio. It is interesting to note that Treasury recommended a $50 billion threshold, but that the NCUA endorsed the lower threshold of $20 billion.

Advertising: The final rule approved at the recent NCUA board meeting allows credit unions a fourth option for using the NCUA official statement for advertising. With the new rule, a credit union can include "Insured by NCUA" within their ads. The final rule also expands the exemption from the advertising statement for radio and television ads from 15 seconds to 30; and removes the requirement for including that advertising statement on annual reports and statement of conditions.

IMPROVING THE VOLCKER RULE

The Volcker Rule has been a hot topic, basically since it was first implemented. While some change occurred under S. 2155, the bulk of the changes ccured under a proposed rule introduced by the five agencies tasked with duties under the Volcker Rule. The Act exempts from prohibitions on propriety trading and relationships with certain investment funds for banks with (1) less than $10 billion in assets, and (2) trading assets and trading liabilities less than 5 percent of total assets. The Act also eases certain Volcker Rule restrictions on all bank entities, regardless of size, related to sharing a name with hedge funds and private equity funds they organize.

On May 30, 2018, the FRB, the Commodity Futures Trading Commission (CFTC), FDIC, the OCC, and the SEC requested comment on a proposed rule all five agencies responsible for Volcker rule administration jointly developed. Specifically, the proposed changes would:

- Tailor the rule's compliance requirements based on the size of a firm's trading assets and liabilities, with the most stringent requirements applied to firms with the most trading activity;
- Provide more clarity by revising the definition of "trading account" in the rule, in part by relying on commonly used accounting definitions, and removes the "purpose" test and the 60-day rebuttable presumption and replacing them with an accounting test and a "presumption of compliance," in certain instances;
- Clarify that firms that trade within appropriately developed internal risk limits are engaged in permissible market making or underwriting activity;
- Streamline the criteria that apply when a banking entity seeks to rely on the hedging exemption from the proprietary trading prohibition;
- Limit the impact of the Volcker rule on the foreign activity of foreign banks; and
- Simplify the trading activity information that banking entities are required to provide to the agencies.

PROPOSED TIERS

The new requirements would specifically entail tailoring the rule's compliance requirements based on the size of a firm's trading assets and liabilities:

Significant: Banks with trading assets and liabilities of more than $10 billion face the strictest compliance regime, including the six-pillar compliance program specified in the 2013 final rule.

Moderate: Banks with trading assets and liabilities between $1 billion and $10 billion are permitted to establish a simplified compliance program that includes CEO attestation.

Limited: Banks with trading assets and liabilities of less than $1 billion have a rebuttable presumption of compliance with the Volcker Rule.

It is informative, too, to compare the changes already adopted and those proposed to the recommendations Treasury gave for Volcker rule reform in their June 2017 report. These included recommendations such as exemptions and tailoring similar to the aforementioned changes, but also focused on making the five agencies "consistent and coordinated." Additionally, there was discussion of giving one federal banking regulator sole oversight of the Volcker process, but this has not yet been addressed in any new proposed legislation.

RECOMMENDED CHANGES TO THE CFPB AND RECENT DEVELOPMENTS

The June 2017 Treasury report took a strong stance on CFPB restructure, recommending sweeping changes to not only the areas over which the agency has jurisdiction (as discussed in the next section of this article), but also to the agency itself and its administrative policies. Some of the changes recommended and addressed in certain proposed legislation pertained to: CFPB structure, CFPB funding, consumer financial civil penalty fund, changes to UDAAP authority, consumer complaint database, supervisory authority, enforcement actions, civil investigative demands (CIDs), retrospective regulatory review and the no-action letter policy.

But, S. 2155 brought no change to the structure of the agency, and no legislation passed thus far has touched the structure or administrative processes. This is not to say, however, that the CFPB has not seen change. The presidential administration has taken action through leadership appointment rather than legislation or rulemaking.

The financial services industry has watched over the last year as legal battles and confusion surrounded the CFPB and its interim leadership after former Director Richard Cordray left office in November 2017. The agency has seen change under Acting Director Mick Mulvaney, and it will likely continue to transform. A recent example of this occured on June 6, 2018, (and in response to comments received on the agency's series of 12 RFIs released since January 2018) when Mulvaney dismissed with no opportunity for re-application all 25 members of the CFPB's Consumer Advisory Board (CAB), in addition to 35 members from two other boards (one that serves issues with credit unions and another that serves small community banks).

On June 19, 2018, Trump nominated Kathy Kraninger to direct the CFPB. On June 28, the Senate Banking Committee announced she will appear before the committee for a confirmation hearing on July 19, 2018. Many democrats on the committee do not support her nomination, and are expected to question her on her experience in consumer financial services (which appears to be limited); her ties to or independence from Mulvaney (and especially which of his changes she will support or continue); and her role in other aspects of the Trump administration's policies.

Furthermore, the CFPB's status remains a hot topic. On June 21, 2018, a New York judge ruled the CFPB structure (specifically regarding the president's ability to only remove a CFPB director "for cause") to be unconstitutional. However, many predict this ruling will have limited effect since it does not affect two decisions from the U.S. Court of Appeals for the D.C. Circuit that upheld the agency's structure; nor is the recent ruling binding on other judges.

RECOMMENDED CHANGES TO CFPB-CONTROLLED AREAS:

The June 2017 Treasury Report recommended changes in several CFPB-controlled areas. While S. 2155 passed some changes into law, financial institutions will not reap the benefits until regulation takes effect. CFPB should now be beginning the rulemaking process for these areas.

KBYO

In their June 2017 report, Treasury advised certain changes to the Truth in Lending Act (TILA)-Real Estate Settlement Procedures Act (RESPA) Integrated Disclosures (TRID), otherwise known as the "Know Before You Owe" (KBYO) mortgage disclosure rule. S. 2155 corroborated these concerns, and requires the CFPB to issue more guidance regarding:

- the applicability of the KBYO rule to mortgage assumption transactions;
- the applicability of the KBYO rule to construction-to-permanent home loans, and the conditions under which those loans can be properly originated; and
- the extent to which lenders can rely on CFPB-published model disclosures without liability if the sample forms do not reflect recent changes to regulations.

S. 2155 additionally removes the three-day waiting period the KBYO rule required when a creditor extends a second offer of credit with lower APR.

ATR/QM

A hot topic going into 2018 was the Ability to Repay/ Qualified Mortgage (ATR/QM) rule, and specifically the "QM Patch," which is a gap created by the differing QM-qualification requirements of either:

1. a debt-to-income (DTI) ratio cap of no more than 43 percent, as laid out in "Appendix Q to Part 1026—Standards for Determining Monthly Debt and Income" (Appendix Q); or

2. eligibility for purchase by government-sponsored enterprises (GSEs; i.e. Fannie Mae and Freddie Mac), the Federal Housing Administration (FHA), or other government programs.

The Treasury Report showed the "QM Patch" to be highly and dangerously favorable to government-supported mortgages, and suggested aligning the QM requirements with GSE eligibility requirements.

S. 2155 adds, under TILA, a new QM category which:

- Is for federally insured banks and credit unions with less than $10 billion in total consolidated assets
- Necessitates the loan be retained in the originating lender's portfolio for the life of the loan, rather than sold to a secondary market purchaser like Fannie Mae or Freddie Mac (the Enterprises)
- Caps the allowable points and fees a borrower may pay at 3 percent of the total loan amount
- Does not include negative amortizing loans or interest-only loans
- Requires the lender to "consider and document the debt, income, and financial resources of the consumer," and while "not to be construed to require compliance with, or documentation in accordance with, appendix Q" of TILA, is to be "construed to permit multiple methods of documentation"

This amendment increases the extent to which community banks can exercise greater professional discretion in lending decisions. According to the Treasury report, many covered banks were hesitant to extend non-QM loans due to the onerous requirements under TILA, which include stringent underwriting requirements. S. 2155's amendments allow covered banks to otherwise judge a borrower's ability to repay and extend loans that will qualify for QM status, provided that the bank follow the guidelines.

HMDA

Additionally, Treasury advised the delayed implementation of new Home Mortgage Disclosure Act (HMDA) requirements set to take effect in 2018, due to concerns over consumer privacy and loan level data publication that may allow competitors to reengineer a lender's pricing model.

S. 2155 provides relief from some of the more detailed HMDA reporting obligations for insured depository institutions that made fewer than 500 closed-end mortgage loans or less than 500 open-end lines of credit in each of the two preceding calendar years. The exemptions are separately applied for closed-end mortgage loans and open-end lines of credit, so institutions can choose one or both types of credit.

Institutions choosing to partake in the exemption would not be required to disclose certain information HMDA requires, but are still required to report on the number and dollar amount of insured or guaranteed mortgage loans, mortgage loans made to investors, home improvement loans and mortgage loans; and completed applications involving mortgagors grouped according to census tract, income level, racial characteristics, age and gender.

PRIVATE SECTOR SECONDARY MORTGAGE MARKET ACTIVITIES

Similar to the goal behind eliminating the "QM patch," Treasury recommended Congress and applicable regulatory agencies make certain amendments to encourage private sector lending activities. These recommendations followed the Report's main themes, and included suggestions for reducing regulatory burden, clarifying rules and jurisdictions and streamlining processes.

To encourage private label mortgage-backed securities (PLS) activities, Treasury made a number of suggestions, including:

- reducing costs and regulatory burden by repealing or revising residential mortgage risk retention requirements;
- giving one agency full responsibility for the rule's interpretation;
- enhancing protections for investors in private label mortgage-backed securities;
- clarifying limited assignee liability for secondary market investors;
- better aligning the regulatory capital framework for structured mortgage products;
- amending SEC's Reg AB II (Asset-Backed Securities Disclosure and Registration) to reduce reporting requirements for registered securitizations;
- and evaluating the Basel III standards' potential impact on the secondary market.

The OMB's June reform and reorganization plan also included a section on reforming the federal role in mortgage finance. The administration proposes ending the GSEs' conservatorships and tailoring the federal programs' delivery, including efforts to increase private sector participation and decrease the Federal subsidies supporting housing. The proposal:

- Removes the Federal charter from statute and fully privatizes the GSEs
- Charges a Federal entity that has secondary mortgage market experience with regulatory oversight of the fully privatized GSEs, granting authority to approve guarantors and promote competition amongst new private guarantors and the GSEs; and ensuring fair access to the secondary market for all market participants, including community financial institutions and small lenders.
- Grants guarantors access to an explicit guarantee on the mortgage backed securities that they issue, that is only exposed in limited, exigent circumstances
- Imposes capital requirements on the guarantors, requiring maintenance of responsible loan underwriting standards, and other protections deemed appropriate by their primary regulator
- Requires the regulator to set fees to create an insurance fund designed to take effect only after the private market incurs substantial losses, including the guarantors, in order to ensure the continued availability of mortgage financing through shifting economic cycles
- Requires legislative and policy changes affecting the mandates of non-U.S. entities
- Entails that the GSEs focus on secondary market liquidity for mortgage loans to qualified borrowers, while HUD assumes primary responsibility for affordable housing objectives by providing support to low- and moderate-income families
- Mandates that the newly fully-privatized GSEs focus on defining appropriate lending markets to level the playing field with the private sector and avoid unnecessary cross-subsidization
- Imposes a separate fee on the outstanding volume of the MBS guarantors issue, to use specifically for affordable housing purposes and transferred through congressional appropriations to, and administered by, HUD
- Provides that the affordable housing fees transferred to HUD enable FHA to provide more targeted subsidies to low- and moderate-income homebuyers

The proposed plan requires congressional approval, and while some in the industry applaud the effort, others believe there is little chance it will come to fruition.

LEVERAGED LENDING

Another lending area the Treasury marked for potential reform is leveraged lending, which is a type of lending banks and other financial institutions provide for mergers and acquisitions, business recapitalization and refinancing, equity buyouts and business or product line build-outs and expansions. Leveraged lending effectively reduces capital strength of loan assets and this gives the bigger banks with larger capital (but not necessarily higher capital ratios) the advantage and ability to buy up smaller community banks.

Following a surge in instances of leveraged lending, in 2013, the OCC, the FRB and the FDIC issued a supervisory guidance on the issue. On November 7, 2014, the agencies published responses to industry participants' FAQs on the guidance. There was mixed feedback on this guidance, including comments regarding the ambiguous definition of "leveraged lending" and the apparent lack of clear consequences for infractions in the field.

Leveraged lending has been the focus of controversy since the guidance was released. On March 31, 2017, Senator Patrick Toomey (R-PA) sent a request to the GAO to determine whether the guidance constitutes a "rule" for the purposes of the Congressional Review Act. In October 2017, the GAO determined the guidance was a "rule."

This is particularly relevant because on May 21, 2018, Trump signed S.J. Res 57 into law, repealing a 2013 CFPB guidance on indirect auto lending that the GAO found to be a "rule" under the Congressional Review Act. Some people believed that the leveraged lending guidance might meet a similar fate, but this has not been the case.

However, due to the fact the GAO did determine the leveraged lending guidance to be a "rule," there has been discussion over institutions' obligations to comply with the guidance. In February, Comptroller of the Currency Joseph Otting said during a Q & A session at a conference in Las Vegas that the guidance is nonbinding. It is up to the banks, he explained, to decide what level of risk they are comfortable with in leveraged lending, as long as they are taking precaution to act in a safe and sound manner.

SMALL BUSINESS LENDING

Treasury believes that the lending climate at the time of their June 2017 report was disadvantageous for small businesses. With the passage of S. 2155, we saw an increase in morale around small business lending. Small Business Administration (SBA) Administrator Linda McMahon stated, "Efforts like this are crucial to creating a more positive environment for America's entrepreneurs. When community banks are able to lend, it means greater access to capital for the 30 million small businesses that are truly the engines of our economy."

Small Business 7(a) Lending Reform

S. 2155 itself did not contain many changes to specifically address small business lending. On June 21, 2018, however, H.R. 4743 (Small Business 7(a) Lending Oversight Reform Act of 2018) became public law, amending the Small Business Act. The new law specifically updates the SBA's 7(a) Loan program, which partners with financial institutions to guarantee loans the institutions make to small business owners for funding startup costs, equipment costs or any other general business purpose. The changes:

- Provide statutory authority for the Small Business Administration (SBA) Office of Credit Risk Management and the SBA Lender Oversight Committee;
- Allow the SBA, with congressional approval, to increase the cap for general business loans if the cap will be reached within that fiscal year, with only one increase permitted annually;
- Require SBA to perform a yearly risk analysis and submit the report to Congress for review.

Dodd-Frank Section 1071

One of Treasury's recommendations to allow lenders to more easily and willingly engage in lending to small businesses was to repeal the application of Section 1071 of Dodd-Frank to small business lending. As part of the Spring 2018 Rulemaking Agenda, the CFPB included that it will focus on the issue this year.

CONCLUSION

Treasury's first report in response to Executive Order 13772 was necessarily broad within the category of depository institutions. The recommendations included were vast, but provide a descriptive outline for where the current administration is focusing its reform efforts. As proof of this, we've seen numerous changes in the year since the Report came out, and especially within the first six months of 2018, that have been in line with the recommendations Treasury set forth.

While the Report was purely consultative, the advised changes clearly follow the major trends and goals of the current administration, and it is clear that many aspects of regulatory and legislative change will follow these goals as well. Looking to the future, we can predict the types of developments we are likely to see, and as always, Capco Center of Regulatory Intelligence will keep your institution abreast of all developments and trends. ❖

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