Significant Banking Regulatory Reform Enacted, Further Legislation May Be On The Way

Overview: Earlier this summer, President Trump signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (the “Act”), enacting the most significant banking regulation reform since the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). The legislation, which enjoyed bipartisan support, responds to concerns expressed by industry stakeholders and regulators alike that many of Dodd-Frank’s regulations and triggering thresholds have resulted in unreasonable and unnecessary compliance costs for smaller financial institutions. This article provides an overview of some of the Act’s key provisions and also highlights further financial reform legislation considered by Congress.

Regulatory Relief and Economic Stimulation

1) Mid-Sized and Other Banks Are No Longer Subject to Enhanced Prudential Standards

The Act scales back existing regulations for certain bank holding companies (“BHCs”). Dodd-Frank automatically subjected BHCs with $50 billion or more in total consolidated assets to enhanced prudential standards, including heightened liquidity, risk management, and capital requirements. The Act raises this threshold from $50 to $250 billion, effective immediately for BHCs with assets below $100 billion, and beginning November 2019 for BHCs with assets between $100 billion and $250 billion.

What it means: This change is particularly noteworthy because regional and other banks that have strategically avoided growth or mergers and acquisitions that would push them across the $50 billion threshold (thereby subjecting them to heightened regulatory scrutiny) might begin to reconsider such opportunities.

2) Certain Types of Deposits Are Exempted From The Definition of Brokered Deposits, Giving Small Banks And Community Development a Potential Boost

The Federal Deposit Insurance Corporation (“FDIC”) has long considered standard brokered deposits—whereby a third party splits a depositor’s money into $250,000 portions and places them in a series of banks to sidestep the cap on federally insured deposits—risky because depositors have no relationship with the banks in which their funds are placed, and they are thus more likely to pull their money out at the first sign of trouble. Accordingly, brokered deposits are subject to heightened regulatory restrictions, such as on the types of financial institutions that may accept brokered deposits and permissible interest rates. Under the new law, “reciprocal deposits” are excluded from these restrictions so long as the deposits, in aggregate, do not exceed the lesser of $5 billion or 20% of the bank’s total liabilities.

What it means: In a reciprocal deposit arrangement, banks divide up their customers’ deposits, in equal amounts, with other banks in a network; for example, for every $250,000 a bank
places in other banks, it receives $250,000 in deposits in return; thus, its customers’ deposits are now entirely insured, and the bank is not without any money. This is especially useful for smaller banks that may not be in a position to lend out such amounts or are not able to attract or handle large-dollar investors. Proponents of this provision believe that by exempting such deposits from heightened regulatory restrictions, community-based financial institutions can more readily participate in such arrangements, which could be a tool for community development: a large-dollar investor may pass over a small bank in favor of investing in a big-name bank who can handle a large account; but, in a reciprocal deposit arrangement, that big-name bank can pass $250,000 of that on to a smaller in-network bank, which can then continue lending within its community.

3) **Online Banking Initiation and Customer Verification is Made Easier**

The Act makes it possible for insured depository institutions, credit unions, and any of their affiliates (as defined in the Bank Holding Company Act) to receive, use, and record an individual’s driver’s license or personal identification card to identify customers’ identity and to comply with connected legal requirements (such as Know Your Customer/Customer Identification Programs and other Bank Secrecy Act requirements) when that individual applies for, or obtains, an online account, product, or service. Prior to the Act, this was illegal in numerous states and many more states had ambiguous laws regarding how a person’s photograph and/or driver’s license information could be collected, used, and retained. Thus, unlike a brick-and-mortar financial institution that can visually verify a customer’s likeness and identifying documentation in-person, financial institutions offering online sign-up and other services have had to develop other processes for verifying a customer’s identity and information, such as by verifying customer-provided information against information in publicly-available databases.

**What it means:** This provision will likely help financial institutions bridge some of the uncertainty created by online interactions with consumers, and may also streamline the initiation process for financial institutions and their customers.

4) **Compliance Costs Are Lessened for Community Banks and Small Holding Companies.**

The Act also contains a number of provisions aimed at easing compliance costs for community banks and small holding companies, including simplified capital requirements for banks with less than $10 billion in total assets that meet certain capital requirements, and exempting such banks from the Volcker Rule (which bans proprietary trading and certain relationships with investment funds) if less than 5% of the bank’s assets comprise trading assets/liabilities. The Act also raises the triggering threshold (from $1 to $3 billion) for the Federal Reserve’s Small Bank Holding Company Policy Statement, which permits qualified banks to enjoy increased balance-sheet flexibility to make acquisitions.

5) **Banks Receive Liability Immunity for Reporting Suspected Senior Abuse**

The Act aims to protect senior citizens from financial exploitation by enabling financial institutions and certain employees (including supervisors, compliance and legal personnel, registered representatives, investment advisors, and insurance producers) to alert appropriate regulatory and law enforcement agencies where they suspect a senior client is being exploited. If such disclosure is made in good faith, with reasonable care, and the covered employee has received specified elder care abuse training provided by the financial institution, the financial institution and covered employees are immune from civil or administrative liability.

**Enhanced Consumer Protections**

In addition to providing regulatory relief for certain banks, the Act also introduces a number of new or enhanced consumer protections and processes related to credit reporting, including for veterans and student borrowers, some of which are highlighted below.

**Credit Reporting:** The Act amends the Fair Credit Reporting Act (“FCRA”) to add several consumer protection measures, including: (1) increasing the amount of time a consumer reporting agency (“CRA”) must include a fraud alert in a consumer’s credit report file from ninety (90) days to one (1) year; and (2) affording consumers a right to place (or remove) a “security freeze” on their credit report—at no cost and an unlimited number of times—after which, a CRA would need to obtain express consumer consent before releasing the consumer’s credit report information to third parties for purposes of extending new credit to the consumer. The Act also requires CRAs to notify consumers that such security freezes are now available and
sets forth additional security-freeze safeguards for protected categories (such as minors and those who are incapacitated).

Veterans: The Act adds several protections related to how certain medical debts must be handled on veterans’ credit reports, including: (i) excluding certain fully-paid but previously delinquent medical debts; (ii) establishing new dispute procedures; and (iii) requiring CRAs to provide active duty military with a free electronic credit monitoring service that, at a minimum, alerts them to material additions or modifications to their credit files. The Act also aims to protect veterans from predatory mortgage refinancing practices by imposing stricter requirements on lenders in order for the U.S. Department of Veterans Affairs to guarantee such loans.

Student Borrowers: Under the Act: (i) lenders are now prohibited from declaring an automatic default or acceleration of a student loan upon the death or bankruptcy of a cosigner; and (ii) consumers may now request the removal of a student loan default from their credit reports (however, removal is permissible only if the borrower satisfies a “loan rehabilitation program” offered by the lender). Additionally, the Financial Literacy and Education Commission must establish best practices for colleges and universities to teach financial literacy skills and help students make informed financial decisions related to student borrowing.

In addition to the key provisions outlined in this article, the Act includes several other provisions that narrowly address mortgage-related and other issues (such as modifying the qualified mortgage criteria under the Ability-to-Repay Rule). An in-depth analysis of the Act by the Congressional Research Service can be found here.

Outlook: The new financial reform law was certainly not without opposition—House Democratic Leader Nancy Pelosi (D-CA) called it a bad bill under the guise of helping community banks and a majority of Democrats opposed it. Moreover, the Act falls short of the sweeping Dodd-Frank overhaul that the Trump administration and many Republicans have been calling for; in fact, the Act preserves many of the fundamental elements of the post-Dodd-Frank regulatory framework, including the ability of regulators to designate and shut down large financial firms that they consider a risk to the financial system and the structure of the Consumer Financial Protection Bureau.

To that end, although the Act’s passage marks the most significant banking regulatory reform in nearly a decade, the Trump administration and Republican-led Congress are continuing their work to provide regulatory relief to financial services companies. In particular, in July, the House passed a large bill – known as the JOBS and Investor Confidence Act – focused on promoting capital formation for smaller financial institutions and their customers and curbing access to funds for criminals engaged in trafficking. The legislation comprises a package of 32 individual, bipartisan bills that had previously been introduced but had not gained significant traction in the legislative process. The consideration of the legislation was promised to House Financial Services Committee Chairman Jeb Hensarling (R-TX) as a concession after Hensarling relented in his efforts to make the Economic Growth, Regulatory Relief, and Consumer Protection Act more sweeping in nature. However, it’s worth noting that the JOBS and Investor Confidence Act enjoyed the support of both Hensarling and his Democratic counterpart on the committee, Ranking Member Maxine Waters (D-CA). The bill may be considered in the Senate in the next few weeks, though will likely only move forward if it is amended to include consumer protection measures supported by Senate Democrats, including legislation supported by Sens. Mark Warner (D-VA) and Elizabeth Warren (D-MA) that would give the Federal Trade Commission authority to assess penalties upon consumer credit bureaus for failure to secure data. We will continue to monitor developments related to this legislation and will report on it in future editions of this briefing.

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