

# PUBLICATION

---

## Financial Services Reform - New Legislation Could Offer Relief for Community Banks

Authors: D. Taylor Tipton

March 23, 2018

**On March 21, the House Financial Services Committee approved a proposal to loosen many of the rules implemented as part of the landmark 2010 Dodd-Frank legislation that overhauled the U.S. financial system in the wake of the 2007 – 2008 financial crisis. The House action followed the bipartisan passage in the Senate earlier this month of a similar bill that would also loosen many of the Dodd-Frank rules and regulations, including raising the asset threshold for systemically important financial institutions (SIFI) status from \$50 billion to \$250 billion, simplification of capital rules for banks with less than \$10 billion in assets, and regulatory relief from the Volcker Rule for certain community banks.**

However, the bill that passed the House Financial Services Committee this week is considerably different from the Senate-passed legislation. House Financial Services Committee Chairman Jeb Hensarling (R-TX), who is retiring from Congress this year, has said the House will not simply rubber stamp the Senate bill and outlined about 30 potential additions he would like to see made to the bill, including changes to the Volcker Rule that would put the Board of Governors of the Federal Reserve System ("Federal Reserve") solely in charge of enforcing the Dodd-Frank Act ban on proprietary trading and investments in private funds. Senators of both parties fired back, saying that the House-proposed changes to the bill would not pass muster in the Senate. The House and Senate have to agree on a single piece of legislation to be sent to President Donald Trump to be signed into law.

It is unclear what the next steps for the legislation will be. That said, the Volcker Rule may be endangered whether the legislation passes or not. The Treasury Department called for the Volcker Rule to be updated along the lines of today's House proposal when it released a series of reports last year on how to revise financial industry rules and regulations. The five agencies currently responsible for the rule's implementation are examining the proposed changes. Streamlining Volcker Rule compliance has long been a top policy priority for large banks.

### Consequences for the Community Banks

While the proposed legislation faces a long road ahead in the House, in any potential conference committee, and in a final vote in both the House and Senate, we believe that the proposed legislation, whether it becomes law or not, indicates largely positive prospects for the community banking industry in three key areas: (i) more large buyers engaged in mergers and acquisitions activity; (ii) the prospect of regulator-initiated capital tailoring; and (iii) a more sensible supervision and enforcement policy.

While the mergers and acquisitions environment has picked up pace in recent years, the number and dollar volume of acquisitions still trails pre-2008 metrics. Some of this is due to a number of large banks – those with more than \$50 billion in assets – largely remaining on the sidelines of mergers and acquisitions activity due to formal regulatory or informal supervisory limits on their growth. If Congress passes legislation to raise the SIFI asset threshold to \$250 billion as proposed in the Senate Bill, it will likely bring 26 large banks into a more assertive role as potential buyers. An influx of potential buyers at the \$50 billion to \$250 billion level may have a trickle-down effect to smaller institutions by providing incentives for banks nearing the \$10 billion and

\$1 billion thresholds to accept greater regulatory scrutiny and grow their balance sheets – either through acquisitions or by organic means – in hopes of being acquired by a larger institution. Such acquisition activity may provide community bankers and their investors with an exit strategy that has been lacking in recent years.

Even without action on the part of Congress, the Federal Reserve and other regulators have significant discretion in tailoring regulations for smaller institutions. For instance, prior to the Senate Bill, the Federal Reserve raised the asset threshold for its presumption that a merger would create a threat to financial stability from \$25 billion to \$100 billion. More recently, the Federal Reserve and the other federal banking regulators issued a proposal that would simplify regulatory capital rules in terms of both the components of regulatory capital as well as the definitions related to those components. The federal banking regulators may view the Senate Bill's community bank regulatory relief related to qualified mortgages, the Volcker Rule, and capital as an invitation to continue to tailor capital and other rules to meet the regulatory and supervisory needs of community banks.

Finally, the Senate Bill indicates Congress's belief that much of the post-financial crisis regulation and enforcement aimed at large, systemically important institutions is inappropriate for community banks. This expression of intent appears to have been heard by federal banking regulators. In a question and answer session at the American Bar Association Banking Law Committee's annual meeting in January, Federal Reserve Vice Chairman Randal Quarles indicated that the Federal Reserve was looking at ways to tailor the supervisory process to the risks posed by community banks, including lengthening the exam cycle for certain highly rated institutions, being more open and transparent with regards to the manner in which applications are processed and acted upon, training examiners to implement guidance and policy documents on a bank-by-bank basis, and reviewing when a deficiency at the bank may be better handled by a matter requiring attention in an exam report or an informal memorandum of understanding, rather than a formal enforcement action.

Each of these developments alone is encouraging, but when taken as a whole, indicate that community banks should expect continued regulatory relief from the federal banking regulators, even if the Senate Bill, or similar legislation, does not eventually become law.