Client Update
The Outlook for Financial Regulatory Reform Under President Trump

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Many expect Donald Trump's inauguration as U.S. president and Republican majorities in both houses of the U.S. Congress will result in a revised financial regulatory framework. Preliminary indications from the Trump transition team have signaled substantial changes may be in the offing, although the exact contours of these changes remain unclear. In this Client Update, we review the potential financial regulatory changes that may take place in the legislative, regulatory and international areas. We focus on issues relevant for the banking industry, capital markets and Securities and Exchange Commission ("SEC") enforcement.

We will continue to monitor developments in these areas closely and expect to provide more detailed analysis as specific proposals are put forward by Congress, the Administration and the financial regulatory agencies.

POTENTIAL LEGISLATIVE CHANGES

Is Congress likely to repeal the Dodd-Frank Act?

- Although we believe a wholesale repeal of the Dodd-Frank Act is unlikely to occur, we think that substantial changes to the Dodd-Frank Act are likely.
- Such changes may have two elements – first, "technical" changes and, second, broader re-workings of the Dodd-Frank Act's regulatory framework. As to the first, there has long been bi-partisan support for "technical" revisions to the Dodd-Frank Act, but those efforts have been stymied by the Obama Administration, which sought to avoid "opening a Pandora's box." With the new Administration, these efforts appear likely to gain steam. The new Administration and Republican leaders in Congress have signaled that they will not stop there but will also seek broader and more comprehensive revisions to Dodd-Frank, including to various provisions that they believe

are misguided and create needless regulatory burdens without commensurate benefits.

What are alternatives to full repeal of the Dodd-Frank Act?

One alternative to a full repeal is the Financial CHOICE Act of 2016 ("CHOICE Act"), sponsored by Rep. Jeb Hensarling (R-TX). The CHOICE Act provides a blueprint for the types of reforms that a Republican controlled House and Senate may pursue.

- That bill, which was introduced earlier this year, would repeal several key provisions of the Dodd-Frank Act, such as the Volcker Rule and Orderly Liquidation Authority, weaken the authorities of the Financial Stability Oversight Council ("FSOC") and restructure the Consumer Financial Protection Bureau ("CFPB"). The CHOICE Act has received partisan support thus far and passed committee largely on party lines without Democratic participation or amendment. [1]
- Rep. Hensarling has stated that the CHOICE Act is in the process of being rewritten; the "2.0" version may step back from some of its more controversial proposals in order to receive broader support.[2] Although the bill, even without modification, may be expected to pass the House, substantive revision may be necessary to garner enough support to pass in the Senate, where procedural measures can be used by the chamber's minority party to hold up legislation.

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[1] Donna Borak, *House Financial Services Committee Passes Bill to Overhaul Dodd-Frank Law*, THE WALL STREET JOURNAL (Sept. 13, 2016, 5:24 PM), http://www.wsj.com/articles/house-financial-services-committee-passes-bill-to-overhaul-dodd-frank-law-1473787619. Democrats on the Committee disparaged the bill as the "wrong choice act."

[2] Rep. Hensarling has stated that his staff and committee welcome "advice and counsel" as they begin to redraft "a 2.0 version." Philip G. Feigen, *Chairman Hensarling Open to Revised Financial CHOICE Act*, THE NATIONAL LAW REVIEW (Nov. 22, 2016), http://www.natlawreview.com/article/chairman-hensarling-open-to-revised-financial-choice-act.

What are some of the key provisions of the CHOICE Act, as currently drafted?

We are tracking the status of the CHOICE Act and anticipate many updates over the coming weeks and months. For now, we highlight some key provisions of the CHOICE Act as written:

- An "off-ramp" offering relief from capital and liquidity standards under the Dodd-Frank Act and Basel III for financial institutions that reach a 10% non-risk weighted leverage ratio threshold;
- A repeal of FSOC authority (a) to designate non-bank financial companies for enhanced supervision and (b) to recommend enhanced prudential standards for large, interconnected bank holding companies ("BHCs");
- A renaming and restructuring of the CFPB to become a bipartisan "Consumer Financial Opportunity Commission" ("CFOC") subject to congressional appropriations and oversight;
- An increase to the asset threshold for CFOC supervision from $10 billion to $50 billion;
- Repeal of the Volcker Rule; and
- Amendments to the Federal Reserve's power, processes and authorities.

Will all CHOICE Act changes be "de-regulatory"?

The majority of the changes likely will be de-regulatory in nature. Some of the de-regulatory changes will focus on process. For example, Title VI of the CHOICE Act requires approval processes for new rules, mandates congressional approvals for all "major" rules and subjects all rules to cost-benefit analyses. (See "Procedural implications" below).

- It is not clear, however, whether all of the CHOICE Act's changes will be uniformly de-regulatory and whether all industry participants will benefit equally from any de-regulatory revisions. For example, the CHOICE Act's "off-ramp" provisions – as currently drafted – would benefit smaller banking organizations, but not necessarily larger ones.
- One reason any bill that emerges from Congress could have re-regulatory elements is the populist streak that runs through both the Democratic and Republican parties. For example, one plank of the platform presented at the Republican convention called for the reinstatement of the Glass-Steagall Act. This is a policy agenda with which left-leaning Democrats, such as Bernie Sanders, agree.

- Whether these sentiments prevail and form part of a larger scheme to impose new restrictions on big banks remains to be seen. Some restrictions on so-called "Wall Street" banks could be added to any legislative effort to garner broader congressional support and to fit within the populist rhetoric that dominated this campaign season.

Does revision or repeal of the Dodd-Frank Act mean that post-crisis reforms will be reversed?

- Even a full repeal of the Dodd-Frank Act, in and of itself, would not necessarily mean a repeal of all post-crisis reforms. Although the Dodd-Frank Act required the Federal Reserve and federal banking agencies to take certain actions (*e.g.*, establish enhanced prudential standards), the federal banking agencies have broad authority to establish prudential and supervisory requirements for banking organizations separate from the Dodd-Frank Act.
- For example, when the Federal Reserve adopted the enhanced prudential standards for large, interconnected BHCs required by the Dodd-Frank Act Section 165, the agency cited a broad range of statutory authorities. As a result, repeal of Section 165 would not necessarily nullify these standards. To use another example, the Federal Reserve's capital planning (or "CCAR") requirements were adopted outside of the Dodd-Frank Act Section 165 rulemaking process and repeal of the Dodd-Frank Act would not, on its own, nullify CCAR.
- The regulatory implications of new legislation may require a granular review and analysis of the authorities under which existing rules were adopted and the way in which any statutory changes affect those authorities and rules.

POTENTIAL REGULATORY CONSEQUENCES

In the following sections, we discuss the substantive and procedural implications of the CHOICE Act on different aspects of the regulatory framework.

SUBSTANTIVE IMPLICATIONS

What would be the impact on private equity?

- Investment advisers to "private equity funds" would be exempt from registration and reporting requirements under the Investment Advisers Act of 1940, but required to maintain records and provide to the SEC annual or other reports as the SEC determines by rule.

  - *The SEC is mandated to define the term "private equity fund." Other types of private fund advisers (e.g., hedge fund managers) would continue to be required to be registered unless otherwise exempt.*
  - *Investors in private equity funds, particularly investors that are subject to their own fiduciary duties (such as pension plans), may raise questions about private equity fund managers taking advantage of this provision.*

- Unless Congress acted specifically to repeal the interagency guidance on leveraged lending, it is likely that it would remain in place, even if the Dodd-Frank Act were repealed, until new leadership at the federal banking agencies decided to re-visit the guidance.

What are the implications for capital raising?

- Registrants with at least one class of common equity securities listed on a national exchange would be eligible to use Form S-3, regardless of public float.
  - *This provision would significantly increase the number of companies eligible to use short-form registration on Form S-3. Note that the provision does not expand eligibility for Form F-3 used by foreign private issuers.*
- Securities Act Rule 436(g), previously repealed by the Dodd-Frank Act, would be reinstated, allowing the inclusion of security credit ratings within an issuer's registration statement without the consent of the credit rating agency.
- A definition of accredited investor would be added to the Exchange Act that would (a) use a $1 million asset test indexed for inflation every five years, (b) use an annual income test of $200,000 ($300,000 jointly with spouse) not indexed for inflation every five years and (c) include any individual who is licensed or registered as a broker or investment adviser and any individual that the SEC determines to have demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment.
- Regulation D would be revised to provide that a "knowledgeable employee" of a private fund or the fund's investment adviser would be an accredited investor for the purpose of a Rule 506 offering of such private fund.
- The SEC would not be permitted to require issuers to submit written general solicitation materials used in a Rule 506(c) offering, except in connection with certain investigations and enforcement actions, and would not be permitted to extend the requirements for sales literature used by registered investment companies to the sales literature used by private funds.

- Regulation D would be changed to permit presentations and communications made by or on behalf of an issuer at specified so-called "investor days" or "demo days," so long as certain restrictions, including on referring to specific offerings or providing investment advice, are observed.

What would be the impact on executive compensation rules and disclosure requirements?

- Clawbacks of incentive compensation under Section 10D of the Exchange Act (mandated by the Dodd-Frank Act) would be limited to situations "where such executive officer had control or authority over the financial reporting that resulted in the accounting restatement."
  - *The SEC's September 2015 proposed Rule 10D-1 uses a "no fault" standard in determining whether executive officers must return compensation. "Control or authority" is not defined in the CHOICE Act but would have meaningful implications.*
- "Say on Pay" votes would be limited to years in which there has been a material change in executive compensation—rather than the current standard of not less frequently than every three years.
  - *Investors and proxy advisors strongly favor annual Say on Pay votes and may advocate for current practice to continue, even if not statutorily required.*
- Pay-ratio disclosure, slated to go into effect for an issuer's first fiscal year beginning on or after January 1, 2017, would be repealed.
  - *We recommend, nonetheless, that registrants continue preparing for pay-ratio disclosure given the uncertainty around CHOICE Act provisions.*
- Mandatory disclosure of hedging policies applicable to employees and directors, mandated by the Dodd-Frank Act and for which the SEC proposed rules in February 2015, would be repealed.
- Limits on incentive compensation at financial institutions mandated by the Dodd-Frank Act and rules proposed in May 2016 would be repealed.

What disclosure requirements mandated by the Dodd-Frank Act may be repealed?

- Conflict minerals reporting, mine safety disclosure, disclosure of payments by resource extraction issuers and disclosure of an issuer's leadership structure (including whether and why it has chosen to combine the CEO and chairman position) mandated by the Dodd-Frank Act would be repealed.

- *We recommend, nonetheless, that registrants continue preparing required conflict minerals reports given the uncertainty around CHOICE Act provisions.*

PROCEDURAL IMPLICATIONS

How would increased congressional oversight change SEC rulemaking authority and process?

The SEC would be required to submit to Congress a complete cost-benefit analysis for any rule, including an analysis of jobs added or lost, and a report containing certain specified information, including: classification of the rule as "major"[3] or "nonmajor," including an explanation of the classification specifically addressing each criterion for a major rule classification.

- A major rule generally would not take effect unless Congress adopts a joint resolution of approval within 70 session or legislative days after the required reports were received by Congress.
- In contrast, a nonmajor rule would not require congressional approval. Instead, Congress has the authority to disapprove nonmajor rules if it adopts a joint resolution of disapproval within 60 session or legislative days after the required reports were received by Congress.
- *Congress could effectively veto a major rule by inaction and veto a nonmajor rule by timely joint resolution. These provisions likely would hinder SEC rulemaking.*

What would be the impact on SEC enforcement authority?

- Any person who is a party to a proceeding brought by the SEC, and against whom an order imposing a cease and desist order and a penalty may be issued, could require the SEC to terminate the proceeding. The SEC could then bring a civil action against that person seeking the same remedy.
  - *This provision is designed to allow respondents to move cases out of administrative proceedings and into federal court.*
- In order to impose a civil money penalty on an issuer for violation of the securities laws, the SEC would be required to publish findings of whether

[3] A "major rule" is any rule that has or is likely to result in (a) "an annual effect on the economy of $100 million or more," (b) "a major increase in costs or prices for consumers, individual industries, federal, state or local government agencies, or geographic regions," or (c) "significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets." (Sec. 634)

(i) the alleged violation resulted in direct economic benefit to the issuer, and (ii) the penalty would harm the shareholders of the issuer.

- SEC authority to bar individuals from serving as officers or directors would be repealed.
- Many "bad actors" would no longer be automatically disqualified (*e.g.*, under Rule 506(d) of the Securities Act of 1934) from using exemption or registration provisions as a result of their bad acts, without the SEC first making a determination, after notice and an opportunity for hearing, of such disqualification.
- Significant increases to monetary penalties for controlling persons in connection with insider trading and securities law violations are proposed.
- Other proposed changes to the SEC enforcement process include: limitations on the duration and renewal of subpoenas; a process for closing investigations and notifying the subjects of the investigation; the creation of an Enforcement Ombudsman to act as a liaison between the SEC and persons who are the subject of investigation; and the requirement for the SEC staff to hold an in-person meeting with any recipient of a Wells notice.

How would the CHOICE Act affect the so-called Fiduciary Rule?

- The so-called Fiduciary Rule issued by the Department of Labor would have no force or effect.

What happens to the CFPB?

- With the new Republican Administration, as well as Republican majorities in the House and Senate, the CFPB is in for some changes. However, Trump has not provided any meaningful statements regarding his stance with respect to the CFPB, and the CFPB's mission somewhat aligns with his populist campaign. It is therefore difficult to predict exactly what these changes will be. Although the CFPB is unlikely to be dismantled completely, post-election, the CFPB could see changes to its structure, as well as significant adjustments to its rulemaking, enforcement and supervision priorities. These points are discussed below.
- *Structural*. Republicans have long advocated for changes to the CFPB's single-director structure, and even before the election, the D.C. Circuit's decision in the *PHH* case made those changes more likely. Under that holding, the court found the CFPB's single-director structure, with the director removable only for cause by the President, unconstitutional, and voided the for-cause requirement, making the director removable by the

President for any reason. The decision is stayed pending appeal, which the CFPB has filed with the D.C. Circuit en banc.

- If the ruling is upheld, it is possible that Trump will replace Director Cordray with his own appointee. However, even if the ruling is reversed, Republicans are likely to continue attacking the CFPB; the CHOICE Act would replace the single-director structure with a bipartisan five-member commission subject to congressional oversight and appropriations and would change the name of the agency to the "Consumer Financial Opportunity Commission."
- *Rulemaking*. The CFPB's rulemaking may also be impacted, particularly those that are not in the final rule stage. The contentious rulemaking on arbitration and payday lending, neither of which has been finalized, likely could be softened or eliminated altogether. However, rules that have been finalized but that are not yet effective, such as the prepaid card rule, face a higher procedural hurdle to be reversed—the CFPB would need to go through another notice-and-comment process to change them.
- *Supervision and Enforcement*. In the longer term, the CFPB's supervision program could be downsized, particularly if the agency becomes subject to congressional appropriations and its budget is cut. On the enforcement side, the CFPB may be less likely to pursue disparate impact claims and other claims of a similarly subjective nature.

What happens to the Financial Stability Oversight Council?

- Perhaps the FSOC's most prominent authority is the ability to designate nonbank financial companies for Federal Reserve supervision.
- The CHOICE Act would significantly weaken the FSOC's authority, though it would not eliminate the FSOC altogether. For example, under the CHOICE Act, the FSOC no longer would have the authority to designate nonbank financial companies or financial market utilities as systemically important—doing away with its main binding authority. The FSOC would continue to serve as an interagency forum for monitoring market developments, facilitating information-sharing and regulatory coordination and reporting to Congress on potential threats to financial stability. It would appear to have a somewhat overlapping function with the Working Group on Financial Markets, established by President Reagan.
- Further, an FSOC chaired by a Republican Treasury Secretary may have a very different focus than the FSOC has under the Obama Administration. For example, rather than focusing on enhancing the regulatory framework, the FSOC could focus on the need for cost-benefit analysis, the role and

accountability of international standard-setting bodies and other de-regulatory initiatives.

- It is also notable that Alex Pollock has been named as leading the Trump transition's "landing team" for FSOC. He has been critical of the way in which FSOC has exercised its authority and accused it of being improperly influenced by politics. [4] Thus, his role could indicate a sharp change in the FSOC's role going forward, even absent any legislative changes to the FSOC's authority.

INTERNATIONAL IMPLICATIONS

What are the implications for "Basel IV" and the Basel Committee more generally?

- The Basel Committee on Banking Supervision (the "Basel Committee") is the primary global standard-setter for the prudential regulation of banking organizations and provides an international forum for cooperation on supervisory matters. Although the Basel Committee's recommendations are not binding on its member jurisdictions, its recommendations represent some degree of consensus by national supervisors as to "best practices" and are often adopted in some form by its member jurisdictions' legislatures. Following the financial crisis, the Basel Committee undertook to update its capital adequacy and liquidity frameworks through an initiative it referred to as "Basel III." Having finalized Basel III, the Basel Committee currently is undertaking a review of the Basel III package of reforms (this effort is referred to colloquially as "Basel IV"), including re-calibrations and additional refinements that ultimately may result in additional burdens for banking organizations if adopted by member jurisdictions. As mentioned above, changes recommended by the Basel Committee would not have binding effect in the United States. Any changes that come out of Basel IV would have to be adopted by the appropriate federal banking agency.
- Absent additional legislative action, repealing the Dodd-Frank Act likely would not have any direct effect on the capital and liquidity adequacy requirements promulgated by the federal banking agencies since the

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[4] Pollock has long been critical of FSOC's effectiveness as an independent regulatory agency. He believes that FSOC's failure to designate Fannie Mae and Freddie Mac as systemically important underscores the agency's undue ties to the government, saying "it is indeed unfortunate if a supposedly technocratic risk committee is governed by politics." Alex J. Pollock, *Fannie and Freddie are Obviously SIFIs*, AMERICAN BANKER (Apr. 21, 2014), http://www.americanbanker.com/bankthink/fannie-and-freddie-are-obviously-sifis-1066993-1.html.

financial crisis, and would not necessarily affect the federal banking agencies' evaluation of the Basel IV package of reforms.

- However, the CHOICE Act would require U.S. public comment processes before federal financial regulatory agencies could participate in international standard-setting processes, such as the Basel Committee. This would require a shift in how the U.S. agencies participate in the Basel Committee today, which is largely done without any public consultation, and could diminish the extent to which the U.S. is able to fully participate in such international standard-setting fora.

What are the implications for international agreements generally?

- Please see our recent client update: "The Outlook for International Law Under President Trump."

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Please do not hesitate to contact us with any questions.