

Chapman Client Alert

May 2, 2017

Current Issues Relevant to Our Clients

Financial CHOICE Act 2.0 “Discussion Draft” Released by House Financial Services Committee

On April 19, 2017, the House Financial Services Committee posted a “discussion draft” of a revised version of the CHOICE Act described in our [December 1, 2016, Client Alert](#). The draft bill was reviewed at a Committee hearing on April 26, 2017.

The discussion draft contains most of the provisions in last year’s bill. Important changes (some of which were outlined in House Financial Service Committee [Chair Hensarling’s February 6, 2017, memo](#) that the press reported on in February) include (1) permitting banking companies to qualify under Title I (now Title VI) by maintaining an adjusted leverage ratio of 10% or greater¹ without regard to their CAMELS² rating, exempting such qualifying companies from stress tests, and revising the framework for all stress tests and the living wills procedure, (2) eliminating completely the CFPB’s supervisory authority, transforming it into a law enforcement agency, eliminating its authority to regulate “unfair, deceptive, or abusive acts of practices” (full Dodd-Frank Section 1031 repeal), and retaining its single Director structure but making the Director terminable at will by the President, (3) overruling the Second Circuit *Madden* decision suggesting purchasers of debt originated by banks or thrifts could be subject to new usury limits, and (4) grandfathering certain “accredited investors” and revising various rating agency related provisions.

The Trump Administration has released the outlines of a major tax reform proposal and has suggested health insurance reform may be resurrected, so it is unclear how much attention Congress will give to the new CHOICE Act proposal. Treasury Secretary Mnuchin has suggested he will issue in June proposals for financial regulation reform, noting in particular possible changes to the Orderly Liquidation Authority and Volcker Rule. Reports also suggest the Senate is considering limited financial regulatory reform on a bipartisan basis. If the House were to pass a bill similar to the discussion draft, it is not clear the bill would ever become law and, if it did, whether the final bill would differ greatly from the discussion draft.

The Committee’s extensive summary of the bill can be [found here](#) and mark-ups of the Tables of Contents for the 2016 bill and the new discussion draft showing corresponding and new or removed provisions in the [two versions are attached](#).

For each Title of the 2016 bill, we summarize below how some features of the discussion draft continue or revise certain major matters our 2016 Client Alert described in each Title of the 2016 bill. We note in parentheses the corresponding Titles of the discussion draft: The above linked House Financial Services Committee summary of the discussion draft provides more detail for each Section, and the entire discussion draft is [available here](#). Depending how the discussion draft develops after last Wednesday’s hearing, we may issue more detailed commentary on the proposed legislation. Our comments below are not based on a detailed review of the discussion draft.

Title I (now Title VI): As noted above, the “off ramp” described in our Client Alert would be available to banking companies meeting the leverage test without regard to CAMELS or equivalent ratings and would also exempt electing companies from stress tests, because the special permission for federal banking regulators to continue such tests (Section 102(b)) has been removed.³

Title II (now Title I): The new Title I still repeals the Dodd-Frank Title II “orderly liquidation authority,” establishes a new Bankruptcy Code subchapter for large financial holding companies, and makes other major reforms contained in the old Title II.

The changes to living will and stress test procedures outlined in Chairman Hensarling’s February 6, 2017, memo are contained in the new Section 151, which revises the 2016 Section 211. The new Section 152 limits capital requirements for operational risk, which only apply to advanced approaches banks.

Title III (now Title VII). As mentioned above, the new Title VII keeps most of the provisions of the old Title III but preserves a single Director for what would be renamed the Consumer Law Enforcement Agency and eliminates all supervisory and examination authority for that Agency. As implied by its new name, the existing CFPB would be transformed into a law

enforcement agency. Section 736 expands on the 2016 Section 337 by eliminating (through repeal of Dodd-Frank Section 1031) the CFPB's authority to prohibit "unfair, deceptive, or abusive actions or practices" (UDAAPs) (not only "abusive" actions and practices) and removing the entire UDAAP provision, not only the abusive part, from the new Agency's Dodd-Frank Section 1021(b)(2) objectives.

The new draft's Section 735 repeals Durbin Amendment just like Sec 335 in the 2016 bill.

Title IV (now Title VIII). The new Title VIII includes numerous new provisions (Sections 828, 831, 833, 844, 845, 848, 849, and 852–856) as noted on the attached marked Table of Contents. As noted there, the 2016 bill's Sections 409 and 415 have been removed. The new Sections 852-856 revise rating agency regulation.

Otherwise, the new Title VIII covers the same matters as the old Title IV, including the Section 842 repeal of risk retention requirements for all ABS except that comprised solely of residential mortgages (Section 442 of the 2016 bill) and the Section 841 (2016 bill Section 441) repeal of the Department of Labor fiduciary rule.⁴

Title V (now Title XI). The new Title XI again establishes an Office of Independent Insurance Advocate to replace the Federal Insurance Office.

Title VI (now Title III). The new Title III continues to impose cost-benefit and congressional review provisions, but no longer restructures the NCUA and OCC into five member commissions. The new Section 341 revises the 2016 bill's Section 641 to provide that *de novo* reviews of agency actions (i.e., overturning the *Chevron* decision) would begin two years after the bill became law.

Title III adds new new Subtitles G (unfunded mandate reform), H (enforcement coordination), I (penalties for unauthorized disclosures), and J (limitations on donations pursuant to settlement agreements).

Title VII (now Title X). New Sections 1001–1011 cover the same matters reforming the Federal Reserve System as Sections 701–711 in the 2016 bill.

Title VIII (now Title II). New Sections 211–221 cover the same matters as Sections 801-811 of the 2016 bill.

Title IX (also Title IX in the new draft bill). Provides the same Section 901 repeal of the Volcker Rule.

Title X (now Title IV). New Sections 401–477 cover the same matters as Sections 1001–1077 in the 2016 bill, and new Sections 481–496 do the same for the 2016 Sections 1081–1096.

As noted in the attached marked Table of Contents for the discussion draft, Sections 478, 479, and 497–499 are new provisions.

Title XI (now Title V). New Sections 501–576 and 586 cover the same matters as the 2016 bill's Sections 1101–1176 and 1191. The discussion draft does not include the Section 1181 Credit Union Advisory Council and Section 1186 extension of NCUA examination cycles provisions in the 2016 bill.

The new Section 581 specifies that a transfer of a loan made by a federally supervised bank or thrift does not cause a different usury limit to apply, effectively overturning the Second Circuit decision in *Madden v. Midland*.⁵

The discussion draft ends with a new Title XII set of "technical corrections" that were not included in the 2016 bill.

For More Information

If you would like further information concerning the matters discussed in this article, please contact the Chapman attorney with whom you regularly work.

1 The adjusted leverage test would measure "common equity Tier 1" (CET 1) capital against Basel III "total leverage exposure" (which adds off-balance sheet exposures to GAAP assets).

2 The CAMELS rating system is a regulatory ratings system applied to U.S. banks. Ratings are assigned based on ratios derived from a bank's audited financial statements combined with on-site regulatory examinations. CAMELS is an acronym for the components of a bank's condition that are assessed, and stands for: (C) = capital adequacy; (A) = assets; (M) = management capacity; (E) = earnings; (L) = liquidity; and (S) = sensitivity (to market risk, especially interest rate risk). Bank holding companies are evaluated under a similar BOPEC system. <https://www.federalreserve.gov/boarddocs/srletters/2004/sr0418.htm>

3 The February 6, 2017, Chairman Hensarling memo describing CHOICE Act 2.0 noted the discussion draft's change to use the total leverage exposure definition in effect when the Act becomes law, rather than the final rule now in effect. It is unclear whether Chairman Hensarling expects the definition to change before the Act would become law.

- 4 For discussions of the Department of Labor Fiduciary rule, see [these Chapman publications](#).
- 5 For discussions of the Madden v. Midland case and its implications, see [these Chapman publications](#).

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Provision of the Financial CHOICE ACT of 2016 and 2017

New to the Financial CHOICE Act of 2017

Financial CHOICE Act of 2016 provision not included in the Financial CHOICE Act of 2017