June 2018

United States Regulatory Update

On May 24, President Trump signed the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) (the Act) into law. This Act provides numerous areas of relief under the Dodd-Frank Act for both banks and credit unions alike. It is important to note that this Act does not provide for any provisions specifically focused on compensatory relief from the Dodd-Frank Act. While a separate bill, i.e., Financial CHOICE Act 2.0, does provide relief for a number of compensation items under the Dodd-Frank Act, its legislative future is uncertain at this point. McLagan will continue to monitor both legislative and regulatory changes that impact compensation management.

The Economic Growth, Regulatory Relief, and Consumer Protection Act

The Act provides numerous areas of relief under the Dodd-Frank Act, including Enhanced Prudential Standards, Stress Testing, the Volker Rule, and Mortgage Lending. The biggest change relates to the designation of a Significantly Important Financial Institution or SIFI. This is one of the more dramatic amendments, impacting banking firms with assets between $50 and $250 billion.

Under the Dodd-Frank Act, the Federal Reserve was required to apply Enhanced Prudential Standards (EPS) to banks greater than $50 billion. The EPS required items such as contingent capital requirements, resolution planning, and limits to short term debt. Under the Act, the level of prescription of EPS moves to $250 billion. However, the Federal Reserve can apply the SIFI status to any firm with assets greater than $100 billion if it is deemed as significantly important to the United States or to ensure safety and soundness of that individual firm.

Similarly, the Act also impacts stress testing, moving the requirement for annual supervisory stress testing as performed by the Federal Reserve to $250 billion in assets. Firms with consolidated assets between $100 billion and $250 billion will be subject to supervisory testing by the Federal Reserve on a periodic basis. Additionally, the requisite for company run stress tests will move from $10 billion to $250 billion. All stress testing will be based upon two scenarios (baseline and severely adverse) as opposed to three scenarios (baseline, adverse, and severely adverse).

McLagan Commentary: *The question on both clients' and our minds is whether this regulatory tailoring will apply to the principles set forth under Sound Incentive Compensation Policies (SICP, June 2010). Specifically, will the SICP construct of enhanced standards for Large Banking Organizations (>$50 billion) move to $250 billion in*

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assets, which is similar to the EPS and stress testing changes, under the Act? SICP requires a higher level of bank incentive compensation program governance and review for Large Banking Organizations, e.g., back testing to determine whether the organization's incentive compensation arrangements may be promoting imprudent risk-taking.

Financial CHOICE Act 2.0

A separate legislative proposal, which would potentially impact several compensation items, is found under the Financial CHOICE Act 2.0. This bill passed the House in 2017 with several items specifically focused on reducing overall regulatory burden for compensation management, such as:

- Repealing the CEO Pay Ratio
- Requiring an advisory vote on say-on-pay only in the years where there was a material change to compensation (as opposed to once every one, two, or three years; note: the vast majority of firms hold these votes every year)
- Repealing the proposed Incentive Compensation Arrangement framework under the Dodd-Frank Act (i.e., section 956, which has not been finalized)
- Limiting the proposed clawback provision under the Dodd-Frank Act (i.e., section 954, which has also not been finalized) to only apply to executives with control or authority over financial reporting that resulted in the accounting restatement (versus all Section 16 officers)

McLagan Commentary: *The Financial CHOICE Act 2.0 would more directly impact how compensation is managed. However, the overall likelihood of passage in its current form appears remote at this time. For example, say-on-pay is becoming more common on a global basis and will be a European Union requirement beginning in 2019. Both the United Kingdom and Australia already have it in place. Although the Senate has agreed to vote on the bill in the coming months, there does not appear to be enough momentum for it to pass. To do so would require at least 60 votes.*

To learn more about the Economic Growth, Regulatory Relief, and Consumer Protection Act and how this will likely affect your firm's compensation management, please contact our team.

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