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The Dodd-Frank Wall Street Reform and Consumer Protection Act

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Overview

- 16 titles; 2000+ pages
- Calls for 60+ studies/reports and 300+ new regulations
- Many provisions will have little or no impact on most banks
- Financial stability:
  - Financial Stability Oversight Council – 10 voting and 5 non-voting members
  - Fed oversight of large BHCs ($50B) & "systemically significant" non-bank financial companies
  - Orderly liquidation authority to FDIC to wind down large financial companies
  - Enhanced Fed authority in supervising risk-management standards for systemically important payment, clearing and settlement activities of banks and non-banks.

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Overview (cont.)

- SEC regulation of most hedge/private equity funds and fund advisors, and national credit rating agencies
- Volcker Rule – Generally prohibits banks from taking part in proprietary trading or holding an interest in a hedge/private equity funds.
  - Exceptions for investments include U.S., state and local debt and obligations of Ginnie, Fannie, Freddie, FHLB, Farmer Mac and Farm Credit System, bank hedging its own risk, and small fund investment

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Overview (cont.)

- SEC and CFTC to have authority over OTC derivatives market; most swaps and derivatives to go through clearinghouse and be exchange traded; some exemption from swap dealer responsibilities for banks hedging their own risks or selling interest rate swaps to loan customers
- Investor protections – SEC authority to impose fiduciary duties on broker/dealers and investment advisors; prohibit or condition use of mandatory arbitration
- Incentive compensation – regulators to prohibit inappropriate incentive based compensation; financial institutions with assets greater than $1 billion to report on structure of all incentive based compensation arrangements

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Overview (cont.)

- Public companies:
  - SEC authorized to grant shareholders proxy access to nominate directors. Encourages splitting of the roles of Chairman and CEO; requires explanation to shareholders in proxy materials when one person occupies both roles.
  - Executive compensation - Gives shareholders a non-binding “say on pay” vote
  - Additional independence requirements for compensation committees.
  - Requires “clawback” policies when compensation is paid based on inaccurate information.

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Overview (cont.)

- Provides Fed emergency lending authority to be used for purposes of providing liquidity and not to bail out individual failing institutions. Adds collateral requirements for loan transactions.
- Provides FDIC guarantee authority for obligations of solvent institutions in response to a liquidity event.
- Fed required to examine non-bank subs of BHCs (other than functionally regulated) in same manner and frequency and using same standards as would apply to lead bank.

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How will it impact my bank?

Dispatches) Quotables

"No one will know until this is actually in place how it works."

Senate banking committee chair CHRISTOPHER DODD, D-Conn., on the financial regulatory bill he helped to craft. He added, "This is about as important as it gets, because it deals with every single aspect of our lives."

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How will it impact my bank?

- Cost
- Expansion
- Competition
- Products and services
- Legal and compliance risk
- Profitability

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Capital

- Agencies to set minimum leverage and risk based capital levels on consolidated basis for insured banks, BHCs and nonbank financial companies supervised by Fed
- Fed to set and enforce capital standards for BHCs and require them to serve as source of strength for insured subs
- Capital standards for banks and BHCs to be “counter-cyclical”
- Annual stress tests for financial companies with assets >$10B
- Deduction from Tier 1 capital of TRUPS and hybrid securities
  - 3 year phaseout starting 2013 for TRUPS issued prior to May 19, 2010 by BHCs with assets > $15B
  - BHCs with assets < $500M exempt

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Deposits & Deposit Insurance Reform

- Changes “assessment base” from domestic deposits to assets (minus tangible equity);
- Permanently increases FDIC insurance to $250,000 per depositor;
- Increases DIF reserve ratio from 1.15 to floor of 1.35 by 9/30/2020;
- Extends unlimited deposit insurance coverage for non-interest bearing transaction accounts for 2 years;
- Allows payment of interest on demand deposits (1 year after enactment).

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Expansion

- Financial holding companies must be “well capitalized” and “well managed” in order to retain status and engage in expanded activities.
  - “no prior approval” provision of the BHCA for activities financial in nature is preserved for acquisitions of up to $10B.
- BHC must be “well capitalized” and “well managed” in order to acquire a bank in another state; surviving bank in interstate merger must be “well capitalized” and “well managed”.
- Interstate de novo branching permitted if state where branch is to be located would allow bank chartered in that state to open such a branch.

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Lending Limits, Insiders & Affiliates

- Purchases of assets from, or sales to, insiders must be on market terms and, if value exceeds 10% of capital, approved in advance by board.
- Lending limits for national banks and Reg. O insider transactions amended to include any credit exposure for derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions.
- State bank lending limits must include credit exposure for derivative transactions.
- Affiliate Transactions - “covered transaction” expanded to include derivative transactions, repurchase agreements, reverse repurchase agreements, and securities borrowing/lending transactions between a member bank and any affiliate.

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Risk Retention

- Sellers of asset backed securities to retain a portion of the risk (e.g., 5% of credit risk)
  - Exemptions for certain qualified residential mortgages and low risk loans (subject to future regulations) and FHA, VA, Farmer Mac and Rural Housing Service loans.
  - Required retention amount can be increased or decreased based on asset quality, etc.
- Some risk will be allocated to loan originators

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Improving Access to Mainstream Financial Institutions

- Treasury authority to provide grants and incentives for institutions to offer traditional bank products and services to non-banked and underbanked.
  - Low cost, small loans; low fee deposit accounts; financial education and counseling

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LEGAL AND COMPLIANCE RISK

OMG …the B of CFP

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Noteworthy

- BCFP independent bureau within the Fed;
- BCFP will write virtually all regulations on consumer credit, products and services;
- "Financial product or service" is all encompassing where banking is concerned (e.g., lending, deposit taking, servicing, etc.).

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The Bureau

- Bureau Director, appointed by the President and confirmed by the Senate – term of 5 years.
- Divisions:
  - Research
  - Collection and Tracking of Complaints
  - Office of Fair Lending and Equal Opportunity
  - Office of Service Member Affairs
  - Office of Financial Protection for Older Americans
  - Office of Financial Education

Mission

- Ensure that consumers have access to markets for financial products and services and that those markets are fair, transparent and competitive;
- Ensure that consumers are provided with timely and understandable information and are protected from unfair, deceptive or abusive acts and practices and from discrimination.

Primary Functions

- Conducting financial education programs;
- Collecting, investigating, and responding to consumer complaints;
- Collecting, researching, monitoring and publishing information on markets for consumer financial products and services to identify risks and market function issues;
- Issuing rules, orders and guidance with respect to consumer financial laws;
- Supervising for compliance and taking necessary enforcement actions.

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Collection of Information

- Bureau has authority to gather information regarding the organization, business conduct, markets, and activities of banks and other covered persons.
- Banks and other covered persons can be required to file reports or answers in writing to specific questions and provide specific information as needed for the Bureau to fulfill its mission.

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Supervision of Banks

- The Bureau has direct and primary examination and enforcement authority for banks over $10B.
- Banks smaller than $10B will continue to be examined by their prudential regulator.
  - Ride along authority on a “sampling” basis
- However, the Bureau can require the prudential regulator to provide reports, records, and documentation related to exams and can recommend actions be taken for violations.

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The Bureau v. Other Regulators

- Bureau has access to any report of examination or financial condition made by a prudential regulator (e.g., FDIC, OCC, Fed, etc.).
- Your primary regulator “may” furnish any report voluntarily to the Bureau.
- Procedures will be developed to furnish the Bureau with information regarding the resolution of consumer complaints filed with the primary regulator.
- The Bureau must coordinate with state supervisory authorities (DB&CF).

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An MOU for Regulators?

- When the Bureau determines that a bank has committed a material violation of law or regulation, the Bureau shall notify the regulator and recommend appropriate action.
- Upon receiving such a recommendation, the regulator shall provide a written response within 60 days.

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Broad Discretion

- Bureau has exclusive authority to write regulations implementing virtually all federal consumer financial protection laws.
- Bureau can define unfair, deceptive or abusive acts and practices and take any action necessary to prevent.
- Disclosures must, at a minimum, use plain language, contain a clear format, be easily readable and succinctly explain information.
- Combined model TILA-RESPA disclosures for mortgage loans.

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Broad Discretion (Cont.)

- Banks must make information available to consumers, upon request, concerning any product or service the consumer has obtained
- Standardized formats for responding to consumers will be developed.

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Preservation of State Law

- A state law that provides consumers greater protection than federal law does is deemed not inconsistent with federal law.
- State attorneys general can bring a civil action in any state or federal court to enforce any consumer financial protection law or regulation, including against national banks and federal thrifts.
- Actions by AG may be brought against national banks.

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Federal Preemption

- State consumer laws are preempted only if the state law "prevents or significantly interferes with the exercise by a national bank of its powers." (Barnett Bank).
  - Case by case decision by OCC in consultation with BCFP
- State consumer law will now apply to non-bank subsidiaries and affiliates of national banks – (reversing Watters).

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Enforcement Powers

- The Bureau may conduct investigations of potential violations by any covered person.
- The Bureau has authority to issue subpoenas, demand documents and conduct discovery.
- Now provides for a special Cease-and-Desist proceeding that is temporary but goes into effect upon service upon the bank.
- Allows the Bureau to bring a civil enforcement action.
- Provides for broad relief (e.g., rescission or reformation of contracts, refund of moneys, restitution, payment of damages, public notification, limits on activities, and civil money penalties).
- Note: No punitive damages.

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Civil Money Penalties

- First Tier – for <u>any</u> violation: $5,000 per day
- Second Tier – <u>reckless</u> violation: $25,000 per day
- Third Tier – <u>knowing</u> violation: $1,000,000 per day
- May be adjusted according to size of the bank, severity of the violation, etc.

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Durbin Amendment

- Amends the EFTA.
- Requires interchange transaction fees charged by issuer for electronic debit transactions be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction" (adjusted for costs of fraud prevention).
- Issuers with assets less than $10B are exempt.
- Allows merchants to provide discounts for cash, check or payment card transactions; set up to $10 minimum for credit card transactions
- Fed to write regulations within nine months.

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Miscellaneous

- Bureau has authority to restrict the use of consumer arbitration agreements (and will).
- The Act provides whistleblower protections for employees that report violations.
- Prospect of criminal referral to the Department of Justice if criminal activity is involved.
- HMDA-like small business loan data collection and reporting.

Mortgage Reform and Anti-Predatory Lending

- Mortgage loan originators
  - BCFP authorized to set minimum net worth, surety bond and qualification standards.
  - Prohibits YSPs and other compensation that varies with loan terms other than principal amount:
  - Prohibits steering to loan consumer lacks ability to repay, has predatory or abusive terms, is not a "qualified mortgage" if consumer eligible for one.
  - Imposes personal liability on MLO for violations (greater of actual damages or 3x compensation plus costs and attorneys fees).

Mortgage Reform (cont.)

- Minimum Standards for Mortgages
  - Requires reasonable determination of ability to repay loan and related obligations based on verified, documented information
    - Safe harbor for “qualified mortgage loan”
    - Effectively prohibits balloon payments with limited exceptions

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Mortgage Reform (cont.)

- Prepayment penalties prohibited on ARMs and loans other than qualified mortgages; restricted on qualified mortgages
- Prohibits financing single premium credit insurance, mandatory arbitration and waiver of statutory causes of action

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Mortgage Reform (cont.)

- Increase civil liability for certain TILA violations and extends statute of limitations for three years for Sec. 129 violations
- Requires monthly billing statement or payment book and specifies content
- Disclosures for: total amount of interest over life of loan as a % of loan amount, aggregate fees paid to MLO, total amount paid for settlement services

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Mortgage Reform (cont.)

- High cost mortgages – lowers rate and fee threshold
  - Prohibits balloon payments; restricts late payment fees, acceleration of payment, financing of prepayment fee or charging fee for renewal, modification
  - Requires pre-loan counseling by independent HUD-certified counselor

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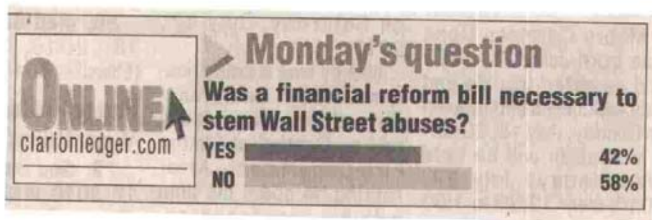
Mortgage Reform (cont.)

- Mortgage servicing
  - Mandatory escrows for all first lien mortgages for five years or until minimum equity level reached
  - Restrictions on fees, force-placed insurance
  - Prompt crediting of payments, prompt payoff statements

Mortgage Reform (cont.)

- Appraisals by independent, certified or licensed appraiser required on all “higher risk” mortgage loans
  - Free copy to applicant
  - Higher priced loans secured by principal dwelling
  - Banking agencies may exempt classes of loans
- Variety of appraisal reforms; agencies to set standards for appraisal management companies, AVMs



ONLINE
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Monday's question

Was a financial reform bill necessary to stem Wall Street abuses?

YES 42%

NO 58%

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