Overview of the Dodd-Frank Wall Street Reform and Consumer Protection Act

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The New Consumer Financial Protection Law: Revolutionary Changes; Revolutionary Challenges

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Title I: Financial Stability

Overview

- Financial Stability Oversight Council
- Federal Reserve's authority over systemically significant companies
- Leverage and risk-based capital requirements
- Office of Financial Research

Title I: Financial Stability

Financial Stability Oversight Council

- Members are the heads of financial services regulatory agencies
- Overall mission is to promote financial stability
- Identifies "nonbank financial companies" for Federal Reserve supervision
- "Financial" means > 85% revenues or assets from financial activities
- Nature, scope, size, interconnectedness, or concentration could pose threat
- Companies must register with Federal Reserve within 180 days

Title I: Financial Stability

Federal Reserve's authority over systemically significant companies

- Nonbank financial companies designated by Financial Stability Council
- In general, bank holding companies with assets of $50 billion or more
- Wide range of regulatory and supervisory powers
- Authority to mitigate "grave risks"
- Risk committee for public companies with assets of $10 billion+ required
- Risk committee for public companies with assets of < $10 billion permitted
- Leverage limit: debt-to-equity ratio of no more than 15 to 1
- In computing capital, off-balance sheet activities must be included

Title I: Financial Stability

Leverage and risk-based capital requirements: Trust preferred securities

The federal banking agencies are required to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions and depository institution holding companies.

The minimum requirements may not be less than the "generally applicable leverage capital requirements" that were in effect for *insured depository institutions* under the Prompt Corrective Action rules as of the enactment date, which are a "floor."

The term "generally applicable leverage capital requirements" means not only the minimum ratios but also the regulatory capital *components* that are allowed for insured depository institutions in the numerator.

Because trust preferred securities were never a permissible component of Tier 1 capital for banks, they will not be a permissible component of Tier 1 capital for holding companies going forward under the new rules.

Title I: Financial Stability

Effective Dates and Phase-In Periods

For debt or equity issued *on or after* May 19, 2010 by holding companies, the provision is deemed to have become effective on May 19, 2010

For debt or equity issued *before* May 19, 2010 by holding companies, any required regulatory capital deductions are to be phased in incrementally over 3 years, beginning on January 1, 2013, except that, for:

•companies with less than $15 billion in assets as of Dec. 31, 2009 and

•companies that were mutual holding companies on May 19, 2010,

no capital deductions will be required.

For thrift holding companies and other holding companies not supervised by the Federal Reserve on May 19, 2010, except as indicated above, the new requirements become effective in 5 years.

Title I: Financial Stability

Exceptions

The new requirements do not apply to:

•debt or equity issued to the US under Emergency Economic Stabilization Act,

•any Federal Home Loan Bank, or

•any "small bank holding company" subject to SBHC Policy Statement

Federal Reserve's SBHC Policy Statement applies to bank holding companies with consolidated assets of less than $500 million that (1) are not engaged in significant non-banking activities, (2) do not conduct significant off-balance sheet activities, and (3) do not have a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the SEC.

Federal Reserve may exclude any company for supervisory reasons.

Title I: Financial Stability

Study

The Government Accountability Office, in consultation with the Federal Reserve, OCC, and FDIC, is required to conduct a study and report to Congress within 18 months on the use of hybrid capital instruments as a component of Tier 1 capital.

The study must consider, among other factors:

- **the current use of hybrids, such as trust preferred, as a component of Tier 1**
- **availability of capital for institutions with less than $10 billion in assets**
- **consequences of disqualifying trust preferred as a component of Tier 1, and**
- **benefits and risks of allowing hybrids to count as Tier 1 capital**

Title II: Orderly Liquidation Authority

Title II receivership process

- Overview
- Financial companies subject to Title II process
- Determination of systemic significance and financial distress
- Commencing the Title II receivership process
- How Title II receiverships operate
- Remedies, recoupment and assessments
- Claw-backs of compensation paid to responsible officers and directors

Title III: Transfer of Powers from OTS

OTS Abolished and Functions Transferred

The OTS is abolished 90 days after the transfer date.

Federal Reserve will regulate thrift holding companies.

OCC will regulate federal savings banks.

FDIC will regulate state savings associations but will *not* write new rules.

OTS rules remain effective until transfer date, and agencies will list OTS rules that will be in effect after the transfer date.

OCC will write new rules for *all* savings associations.

OTS employees will be transferred to OCC or FDIC, but not Federal Reserve.

Transfer date: 1 year after enactment unless Treasury extends by 6 months.

Title III: Transfer of Powers from OTS

Deposit Insurance

- Standard deposit insurance amount is increased to $250,000
- Assessment base changed to total assets minus tangible equity
- Required dividend payout when reserve ratio exceeds 1.35% is repealed
- Dividend payout when reserve ratio exceeds 1.50% is made permissive
- Minimum reserve ratio is increased from 1.15% to 1.35%
- Maximum reserve ratio of 1.50% is repealed
- Non-interest bearing transaction accounts will be fully insured as of 12/31/2010
- Non-interest bearing transaction accounts do not include NOW accounts
- Coverage of non-interest bearing transaction accounts sunsets on 01/01/2013
- Bureau Director replaces OTS Director on FDIC Board of Directors

Title IV: Investment Advisers

Advisers to Hedge Funds and Others

- General elimination of private adviser exemption
- Exemptions to registration for investment advisers
- Record-keeping and reporting requirements
- Adjusting the accredited investor standard
- Studies and reports
- Title IV effective date is one year after date of enactment

Title V: Insurance

Insurance reform

- Federal Insurance Office established
- Health and long-term care insurance are not within FIO's jurisdiction
- FIO's primary role is to monitor, not regulate
- FIO may recommend insurance companies to FSOC as systemic risks
- FIO may preempt state insurance laws discriminating against non-US issuers
- State-based insurance reforms

Title VI: Improving Bank Regulation

Per-Borrower Lending Limits

The House bill and later the Senate bill would have imposed the per-borrower lending limit applicable to national banks on all state-chartered banks.

National bank limit: 15% of capital and surplus unsecured, and an additional 10% secured by readily marketable collateral

These provisions were ultimately struck from the final conference committee bill.

Title VI: Improving Bank Regulation

Derivatives

The Act includes in the national bank lending limit calculation any "credit exposure" to a person arising from a derivative transaction, repurchase agreement, securities lending or other similar transaction.

The Act provides that an insured state bank *may engage in a derivative transaction only if* the state lending limit "takes into consideration credit exposure to derivative transactions." (effective 18 mos. after transfer date)

Title VI: Improving Bank Regulation

Proprietary Trading: Equity and other investment securities

The Act prohibits, with certain exceptions, an insured bank or savings association from engaging in proprietary trading.

Proprietary trading means engaging as a principal for the *trading account* of the institution in any purchase or sale of any security that the federal banking agencies, the SEC, and the CFTC may by rule decide to cover.

A "trading account" is any account used to acquire or take positions in securities principally for the purpose of "selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)."

However, "trading accounts" also include "any such other accounts as the appropriate federal banking agencies, the SEC, and the CFTC may by rule determine."

Title VI: Improving Bank Regulation

Proprietary Trading: Equity and other investment securities

A bank purchasing debt or equity securities for investment, including exercising grandfathered authority under FDICIA to hold publicly traded equity securities, would not appear to be subject to the prohibition on proprietary trading as long as the bank's activities are not:

•principally for the purpose of selling in the *near term*, or

•otherwise with the intent to sell to profit from *short-term* price movements.

The Act requires the Financial Stability Oversight Council to study and make recommendations not later than 6 months after the date of enactment of the Act on implementing these restrictions.

Not later than 9 months after the completion of the study, the federal banking agencies, the SEC, and the CFTC, are required, with certain exceptions, to consider the findings of the study and adopt rules to carry out the statute.

Title VI: Improving Bank Regulation

Proprietary Trading: Equity and other investment securities

The following activities, among others, are permitted activities: the purchase or sale of obligations of the United States, a federal agency, or any Federal Home Loan Bank; obligations of any State or any political subdivision; certain risk-mitigating hedging activities; certain purchases or sales on behalf of customers; investments in small business investment companies, investments designed primarily to promote the public welfare; and other activities permitted by the banking agencies, the SEC and CFTC.

A transaction will fail to qualify as a permitted activity if, among other things, it would result in a material exposure by the banking entity to *high-risk* assets or *high-risk* trading strategies.

In general, these restrictions take effect on the earlier of 12 months after the date the rules are issued or 2 years after enactment.

An institution is required to bring its activities and investments into compliance with the requirements of this section not later than 2 years after the date on which the requirements become effective.

Title VI: Improving Bank Regulation

Interstate branching

The Act relaxes the current rules on de novo interstate branching.

The Act allows national banks and state chartered banks to branch into another state, with regulatory approval, if the law of the state in which the branch is to be located would permit establishment of the branch by a bank chartered by that state.

The current rule, which the Act eliminates, is that there must be in effect in the host state a law that applies equally to all banks and *expressly permits* all out-of-state banks to establish de novo branches in the state.

Only approximately 18 states have enacted laws expressly permitting out-of-state banks to establish de novo branches, while the vast majority have not.

The new provisions are effective on the date of enactment.

Title VI: Improving Bank Regulation

Insider transactions: Purchases or sales of assets

The Act extends Reg. O – like restrictions to purchases of assets from or sales of assets to insiders.

The Act prohibits a bank or savings association from purchasing an asset from, or selling an asset to, an executive officer, director, or principal shareholder, or any related interest, unless it is on "market terms."

If the transaction represents more than 10 percent of the capital stock and surplus of the bank or savings association, the transaction must be approved in advance by a majority of the board of directors who do not have an interest in the transaction.

The Federal Reserve may issue rules implementing the provision after consulting with the OCC and FDIC.

These provisions take effect on the transfer date.

Title VI: Improving Bank Regulation

Dividend waivers

The Federal Reserve may not object to a dividend waiver by a mutual holding company that owns or controls a savings association if:

- **the waiver would not be detrimental to thrift's safe and sound operation,**
- **Board of Directors of MHC determines waiver is consistent with duties, and**
- **prior to December 1, 2009, MHC waived dividends**

Agencies must consider waived dividends in determining an appropriate exchange ratio in full conversion to stock, except that:

- **if savings association reorganized into MHC, issued minority stock and**
- **waived dividends prior to December 1, 2009,**

then the agencies cannot consider waived dividends in setting an appropriate exchange ratio in the event of a full conversion.

Title VI: Improving Bank Regulation

Other provisions

Moratorium on industrial banks, credit card banks and trust banks

Financial holding companies must be well capitalized and well managed

Restrictions on charter conversions

Countercyclical capital requirements

Source of strength doctrine expanded beyond bank holding companies

Interest on demand deposits permitted

Credit card banks can make small business loans

Sponsor conflicts of interests prohibited in connection with securitizations

Title VII: Wall Street Transparency

Derivatives

Registration of swap dealers and major participants

Swap contracts, in general, must be cleared and exchange traded

Exemptions for certain end users

SEC and CFTC required to consider exemption for banks < $10 billion

SEC and CFTC to impose capital and margin requirements

Public reporting of swap transaction data

Position limits

No government bailouts of swaps entities

Title VIII: Payment Systems

Payment, Clearing and Settlement Supervision

Risk management standards for:

- **systemically important payment, clearing and settlement (PCS) activities**
- **systemically important financial market utilities (FMUs)**

FSOC to designate systemically important PCS activities and FMUs

In general, Federal Reserve, SEC and CFTC to establish standards

FSOC and Federal Reserve to have monitoring roles

FMUs to have access to discount window

Oversight and examination of FMUs

Title IX: Investor Protection

Improvements to the regulation of securities

Investor Advisory Committee and Office of the Investor Advocate

Standards of care for broker-dealers and investment advisers

SEC authority to restrict mandatory arbitration agreements

Bad actors barred from Reg. D private offerings

Amendments to Security Investor Protection Act

Office of Credit Ratings established within SEC

"Skin-in-the-game" credit risk retention requirement in securitizations

Executive compensation and corporate governance rules

Title X: Consumer Protection

Bureau of Consumer Financial Protection established in Federal Reserve

Director appointed by President with advice and consent of Senate

Director serves five-year term

Bureau will regulate "consumer financial products and services"

•Insurance products are *not* covered

Bureau will administer "federal consumer financial laws"

Financial Stability Oversight Council may veto a regulation

Civil penalty fund established

Bureau, after a study, may restrict mandatory arbitration agreements

Title X: Consumer Protection

Federal Reserve May Delegate Examination Authority to Bureau

In general, prudential regulators have exclusive consumer compliance examination and enforcement authority over insured depository institutions with total assets of $10 billion or less.

However, Section 1012 of the Act allows the Federal Reserve to delegate to the Bureau consumer compliance examination authority over bank holding companies and state member banks "notwithstanding any other provision of law."

To the extent that the Bureau and another federal agency are authorized to enforce a federal consumer financial law, the Act gives the Bureau *primary* authority to enforce that federal consumer financial law.

The Bureau is required to coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and state bank regulatory authorities, including in scheduling examinations.

Title X: Consumer Protection

Specific powers

Prohibiting unfair and deceptive acts and practices

Disclosure requirements

Consumers must understand the costs, benefits and risks of a transaction

•Combined TILA and RESPA disclosures required

Consumer access to account information

Responses to consumer complaints

Title X: Consumer Protection

State law and its relation to federal law

State power to enforce state law preserved

States have power to enforce Dodd-Frank and regulations issued under it

States can bring actions against national banks to enforce Bureau rules

Preemption determinations must be on case-by-case basis

To be preempted, state law must discriminate against national banks, be preempted by another federal law, or "prevent or significantly interfere" with a right granted under National Bank Act

National banks' interest rate exportation powers unaffected

Judicial review

Title X: Consumer Protection

Truth-in-Lending Threshold for Exempt Transactions Raised

The Act raises the thresholds for small credit transactions exempt from the Truth in Lending Act and for small lease transactions exempt from the consumer leasing provisions of TILA from $25,000 to $50,000.

As a result, a credit or lease transaction that formerly was exempt because the amount of the transaction exceeded $25,000 will now be covered unless the transaction exceeds $50,000.

The CFPB is required to make an annual adjustment for inflation on and after December 31, 2011.

The provisions take effect on a date that the Secretary of the Treasury will publish within 60 days. The effective date must be between 6-12 months from the date of enactment, although it may be extended by another 6 months.

Title X: Consumer Protection

Interchange Fees on Debit Cards

The Act limits an interchange fee that an issuer may receive in an electronic debit transaction to an amount which is "reasonable and proportional to the cost incurred by the issuer with respect to the transaction."

The Federal Reserve must issue regulations within 9 months to establish standards for determining whether an interchange transaction fee is "reasonable and proportional" to the cost incurred by the issuer.

The requirements do *not* apply to any issuer that, together with its affiliates, has assets of *less than $10 billion*, and the Federal Reserve is required to exempt those issuers from its regulations.

The term "issuer" means the person holding the asset account that is debited through an electronic debit transaction.

These provisions take effect 1 year after enactment.

Title XI: Federal Reserve Provisions

Restrictions on use of emergency powers, and governance changes

Use of emergency lending authority for systemic programs only

Federal Reserve may not aid a specific failing company

Reports to Congress required

GAO audits of credit facilities

Public access to information

Emergency financial stabilization permitted to address "liquidity events"

Federal Reserve Bank board governance changes

Public disclosure of emergency assistance

Title XII: Improving Access

Improving access to mainstream financial institutions

Treasury authorized to establish grants and programs to improve access to mainstream financial institutions

Targeted at low and moderate income individuals

Funds would be provided to community development financial institutions

Banks could partner with community development financial institutions

Title XIII: EESA Amendments

Pay It Back Act

TARP authorization reduced

No new programs

Semi-annual reporting required

Title XIV: Mortgage Reform

Mortgage lending and anti-predatory lending reform

Prohibitions on incentives to steer borrowers

Changes to TILA civil liability

Federal Reserve to define unfair and deceptive practices

Borrower's ability to re-pay must be considered

Limitations on prepayment penalties

Mandatory arbitration agreements prohibited

Disclosure and counseling if loan could involve negative amortization

Additional TILA disclosure requirements

Title XIV: Mortgage Reform

Mortgage lending and anti-predatory lending reform

New mortgage servicing requirements

Restrictions on force-placed hazard insurance

Prompt crediting of home loan payments required

Escrows included in repayment analysis

New requirements on appraisal practices

Title XV: Miscellaneous

Studies and reports

GAO study of inspectors general

FDIC study of core deposits

Title XVI: Section 1256 Contracts

Tax law change

Definition of "Section 1256 contract" amended

Section 1256 contracts are treated as sold at their fair market value at year end

Swaps are now generally excluded