

**O**N JULY 21, 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. With 16 titles covering various aspects of banking, the reform act is very broad, complex legislation that puts in place a sweeping new financial services regime. Remember the quote by the German philosopher Friedrich Nietzsche, “That which does not kill us makes us stronger.” Perhaps this was Congress’s intention. We can only hope.

# SWEEPING REF

Of the act’s 16 titles, two—Title X, which creates the Bureau of Consumer Financial Protection, and Title XIV, which enacts mortgage reform—are particularly critical to bank compliance risk management. (The individual titles can be found at [www.aba.com/RegReform/RR\\_TitleMenu.htm](http://www.aba.com/RegReform/RR_TitleMenu.htm).) Full comprehension of the legislation and its implications may take a while. Fortunately, the effective dates for some of the compliance-related provisions provide time to do that, because many of the act’s provisions become effective upon certain events, such as the writing of a new rule or a “transfer” date (i.e., when regulations are transferred to the new consumer bureau covered later in this article). For now, it is important to be aware of the legislation’s overall objectives and understand which provisions directly affect compliance. This initial article, along with articles in later editions, will assist compliance professionals in that process.

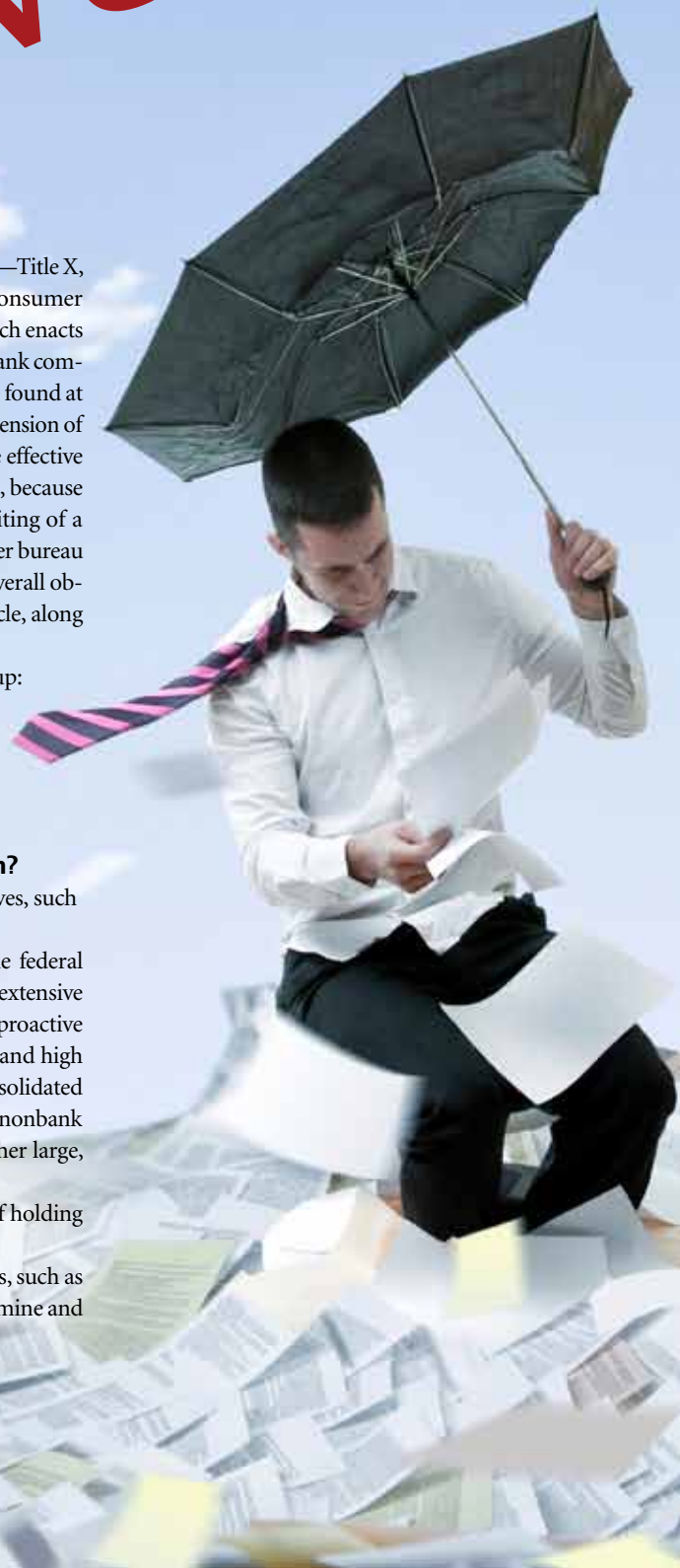
Let’s start with four key questions with responses that provide you with a heads-up:

- What do you need to be aware of regarding the overall legislation?
- What are the key compliance provisions?
- What other pertinent information should compliance professionals be aware of?
- What should you be thinking about and taking action on now?

## What Do You Need to Be Aware of Regarding the Overall Legislation?

All banking professionals need to be aware that the act promotes substantial initiatives, such as the following four objectives:

- 1. A new, risk-based approach to financial services regulation:** The federal bank regulatory agencies, and in particular the Federal Reserve, have been given extensive new authority to monitor the systemic safety of the financial system and to take proactive steps to reduce or eliminate threats. These steps include imposing strict controls and high standards of prudence on large bank holding companies (BHCs) with total consolidated assets equal to or in excess of \$50 billion and on designated systemically significant nonbank financial companies to limit the risk they might pose for the economy and to other large, interconnected companies.
- 2. Increased bank supervision:** The reform act restructures the supervision of holding companies and depository institutions in several respects, such as by
  - enhancing the authority of the Federal Reserve to examine nonbank subsidiaries, such as mortgage affiliates, and also giving other bank regulators the opportunity to examine and take enforcement action against such entities





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# How It Affects You

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- eliminating the Office of Thrift Supervision (OTS) and re-allocating savings and loan holding company supervision to the Federal Reserve; federal savings institution supervision to the Office of the Comptroller of the Currency (OCC); and state savings institution supervision to the Federal Deposit Insurance Corporation (FDIC). The thrift charter is nonetheless preserved; new charters may be issued by the OCC. (Note: The transfer of the OTS's function and employees must be completed within 12–18 months of the act's enactment.)

**3. Heightened focus on consumer protection:** The reform act establishes a new federal regulatory body for consumer protection. Known as the Bureau of Consumer Financial Protection, it will be an independent entity within the Federal Reserve System that will assume responsibility for most consumer protection laws. In particular, it will have broad authority to

- supervise, examine, and take enforcement action with respect to (i) depository institutions with more than \$10 billion in assets and (ii) nonbank mortgage industry participants and other bureau-designated nonbank providers of consumer financial services
- curb practices it finds to be unfair, deceptive, or abusive [Note: This sounds an awful lot like unfair and deceptive acts or practices (UDAP) covered under Section 5 of the FTC Act, right? Well, proceed with caution—the reform act has expanded the concept to include “abusive.” Broadly defining this term may promote increased litigation. We affectionately refer to this new standard, “UDAAP,” as “UDAP on steroids.”]

**4. Heightened regulation of mortgages:** The act significantly increases the regulation of mortgage lending and servicing by banks and nonbanks by

- requiring mortgage originators to act in the best interests of consumers
- seeking to ensure that consumers will have the capacity to repay their loans
- mandating comprehensive additional residential mortgage loan-related disclosures
- requiring mortgage loan securitizers to retain a certain amount of risk as established by the regulatory agencies (i.e., retain a percentage of loans sold) (Note: Mortgages that conform to the new regulatory standards as “qualified residential mortgages” will not be subject to risk retention requirements.)

► **Heads-up:** Implementation of the reform act will require literally hundreds of new mandatory and discretionary rulemakings by numerous federal regulatory agencies over the next several years. For a sense of the rule writing “players,” please refer to the table at [www.aba.com/aba/documents/RegReform/Rulemaking.pdf](http://www.aba.com/aba/documents/RegReform/Rulemaking.pdf).

### What Are the Key Compliance Provisions?

We believe the Bureau of Consumer Financial Protection is the most critical compliance provision in the reform act because of its broad rulemaking and oversight authority.

**What are the bureau's official goals?** The act enumerates several goals for the bureau. These goals, which will be evident in how the bureau writes its regulations, include the following:

- ensuring that consumers receive timely and understandable information (disclosures)
- protecting consumers from unfair, deceptive, or abusive acts or practices
- addressing outdated, unnecessary, or unduly burdensome regulations (don't get your hopes up)
- enforcing federal consumer financial laws consistently, without regard to the status of a depository institution (size, regulator, business model, etc.)
- ensuring the transparent and efficient operation of markets for consumer financial products and services

► **Heads-up:** Remember, the bureau's chief mandate is to look out for the interests of consumers, not financial institutions.

**When and how will the bureau operate?** Technically, the bureau came into being on July 21, 2010, the date the act was signed into law. Its powers commence as of the “transfer date,” which will be determined by the Treasury secretary, but must be within six to 12 months of the act's enactment, with the possibility of an extra six-month extension if needed. (Note: The transfer date is important because it drives many of the effective dates of Title X's provisions.)

The bureau will be headed by a director appointed by the president and confirmed by the Senate. Until a director is appointed and confirmed, the Treasury secretary has authority to make decisions for the bureau. The bureau will be staffed by employees of agencies that include the Federal Reserve, FDIC, OCC, and OTS, as well as the Federal Trade Commission (FTC), the U.S. Department of Housing and Urban Development (HUD), and the National Credit Union Association (NCUA).

As of this writing, we do not have an estimate of the size of the bureau staff, although planning efforts have commenced. For example, soon after the reform act was signed into law, the Treasury secretary and Federal Reserve chairman met with the heads of the FDIC, FTC, OCC, OTS, NCUA, HUD, and Office of Management and Budget. The bureau is expected to be fully staffed within a year of enactment.

**What will the bureau do?** The bureau has independent authority to make rules, give Congressional testimony, make recommendations, conduct examinations, and take enforcement action to ensure consumer protection in the provision of financial services. The bureau's rule writing authority will cover a broad range of providers and retail financial products, including checking accounts, private student loans, and mortgages. (Auto dealers are exempt from the agency's oversight.) The scope of the bureau's rulemaking authority includes the following:

**Federal consumer financial laws,** including specifically enumerated laws such as Regulations B, C, E, Z (including HOEPA), V, and DD, and RESPA, FCRA, RFP, SAFE, FCFA, and FDICPA. (Rule writing for CRA is not transferred to the bureau, although it will house a community affairs function. In addition, neither Section 5 of the FTC Act nor the Fair Housing Act (FHA) has been transferred to the bureau. Reg. CC would be shared with the Federal Reserve, and it is fair to assume the bureau's role with respect to Reg. CC would focus on disclosure and funds availability practices.) ► **Heads-up:** The bureau, the prudential regulator (e.g., the Federal Reserve, the FDIC, the OCC), or both could be

involved in exams that enforce fair lending or unfair and deceptive acts or practices compliance.

Rules, including those to identify and prevent unfair, abusive, or deceptive acts or practices. For example, fees could be outlawed if a bank has taken “unreasonable advantage” of the consumer. Heads-up: There will be much rulemaking on the bureau’s part regarding products and practices it feels are abusive, as well as unfair or deceptive. The terms “unfair” and “deceptive,” found in the FTC Act, are well defined; “abusive” is not. Due to the legal vagueness of the term “abusive,” there may for some time be much confusion around what exactly is allowable and what is not, perhaps prompting litigation involving previously acceptable banking practices and potentially stifling product innovation due to the regulatory and legal risk.

**Examinations.** The bureau has examination and primary enforcement authority for federal consumer financial laws for the following types of institutions:

- **Financial institutions with assets of greater than \$10 billion and their affiliates.** Note that the prudential regulators have primary consumer examination and enforcement authority over financial institutions with total assets of \$10 billion or less. These agencies also have backup enforcement authority for institutions with assets greater than \$10 billion in assets and their affiliates. This means we may see a lot of effort to coordinate exams across agencies. ► **Heads-up:** The bureau has the right to include its examiners on a “sampling” basis in examinations conducted by the prudential regulators. It is also authorized to give the agencies input and recommendations with respect to consumer protection laws and to require reports and other examination documents. Finally, the bureau can also make referrals and recommend action to the prudential regulator when there is “reason to believe” an institution has violated federal consumer law. For example, the bureau may inquire on activities in response to complaints it has received regarding a particular institution. Prudential regulators must respond within 60 days.
- **Nonbanks** that
  - offer or provide origination, brokerage, or servicing of residential mortgage loans or foreclosure relief services in connection with such loans
  - are “larger participants” in a market for other consumer financial products or services (as defined by bureau rule)
  - offer or provide payday loans or private education loans
  - generate consumer complaints that lead the director to determine the covered persons are engaging in conduct that poses risks to consumers with regard to the offering or providing of consumer financial products or services.

**For now, it is important to be aware of the legislation’s overall objectives and understand which provisions directly affect compliance.**

Several functional units will be housed within the bureau to highlight their significance relative to the bureau’s overall mission, including

- Office of Financial Literacy
- Office of Fair Lending and Equal Opportunity
- Office of Service Member Affairs
- Community Affairs

The bureau will also establish a national consumer complaint hotline, an effort that will likely leverage from the centralized programs established by a number of the other agencies including the Federal Reserve. The feedback from complaints will likely support its monitoring of all institutions, including banking organizations with less than \$50 billion in assets.

In addition to creating the bureau, the reform act has dedicated an entire title (Title XIV) to heightening consumer protections in mortgage lending. These protections include the following:

1. **Ability to repay.** Requires creditors to make a reasonable, good-faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay a residential mortgage loan at the time the loan is consummated. There is a rebuttable presumption that a mortgage meets the ability to repay requirements if it meets specified standards governing rates and terms. Similar to the existing high priced mortgage loan (HPML) rule under Reg. Z, the provision requires documented and verified information.
2. **Steering incentive ban.** Prohibits yield spread premiums and other mortgage loan originator compensation that varies based on the terms of the loan (other than the amount of the principal). This settles the long debate over RESPA Section 8, as the rule allows only flat fees or variable fees based on other than loan terms. No longer will broker fees (or fees paid to other third parties) be permitted to be based on the amount of the loan.
3. **Prepayment penalty phase-out.** Phases out prepayment penalties and prohibits them after three years. For adjustable rate and certain higher-priced mortgages, prepayment penalties are prohibited upon enactment of the legislation.



## Additional data collection requirements for small business and mortgage loans

	Small Business Loans Under ECOA/Reg. B	HMDA Data Elements to Be Reported
1	Indication whether woman-owned or minority-owned	Age
2	Application number	Total points and fees at origination
3	Application date	Prepayment penalties
4	Type/purpose of loan	Value of the collateral property and parcel number
5	Loan amount	Introductory period for variable-rate loans
6	Action taken	Contract terms for non-fully amortizing payments
7	Census tract	Loan term
8	Gross annual revenue	Channel (broker, retail, etc.) through which application was received
9	Race/ethnicity/gender of principal owner of business	SAFE Act/Nationwide Mortgage Licensing System and Registry (NMLSR) unique identifier
10	Other data to be determined	Credit score

4. **Interest rate reset notice.** Requires creditors to notify consumers at least six months before the interest rate on a hybrid adjustable rate mortgage is scheduled to reset.
5. **Periodic statements.** Requires additional disclosures on periodic statements, e.g., the maximum that the borrower could pay on an ARM, with warning that payments will vary based on interest rate changes.
6. **Escrows.** Requires escrows for taxes and insurance for certain mortgages (including those exceeding specified interest rate thresholds).
7. **Broader HOEPA coverage.** More loans will receive the protections afforded high-cost mortgages under the Home Ownership and Equity Protection Act of 1994 (HOEPA). The expanded scope will be facilitated by lower HOEPA triggers: Trigger rates would fall to 6.5 (first lien) and 8.5 (junior lien or loan less than \$50,000); trigger points/fees would be 5 percent for loans greater than \$20,000; 8 percent of loan amount or \$1,000 for loans less than \$20,000.
8. **Appraisal reform.** Requires written appraisals based on physical inspection of the property, and in some cases second appraisals for “higher-risk mortgages.” A broker price opinion may not be used as the primary basis for determining the value of property that would secure a mortgage for the purchase of a consumer’s principal dwelling. The agencies are required to issue joint regulations on the appraisal requirements for higher-risk mortgages, appraisal management companies, and automated valuation models. They may also issue additional joint regulations and guidance on appraiser independence.
  - **Heads-up:** Federal Reserve interim final regulations defining acts or practices that violate appraiser independence are required no later than 90 days after enactment.
9. **Predatory lending penalties.** Imposes penalty provisions on lenders that engage in designated predatory practices. Penalties include forfeiture of three years in interest payments

and attorney’s fees. In addition, borrowers are allowed a defense in foreclosure. ► **Heads-up:** The reform act generally requires final regulations for most of the foregoing mortgage protections (Title XIV) within 18 months of enactment.

Outside of Title XIV, the reform act also includes other consumer protections that address a variety of banking products and services:

**Additional data collection requirements for small business and mortgage loans.** The table at left recaps the data elements in the reform act.

**Disclosure of credit scores.** Under amended FCRA provisions, credit scores must be provided to consumers at no cost if they negatively impact a financial transaction or hiring decision. The credit score will be included in adverse action and risk-based pricing notices.

**Truth in Lending (Reg. Z) applicability.** Reg. Z now applies to non–real estate–secured transactions of \$50,000 or less, up from \$25,000. However, additional disclosures may be required “as necessary to promote understanding of the product or service.” What these will look like is up to the bureau to determine.

**Mortgage loan changes: TILA and RESPA.** To the potential delight of loan officers and compliance officers everywhere, the bureau is charged with developing a single, integrated disclosure for mortgage loan transactions that will replace both the Truth in Lending (TIL) disclosure under Reg. Z and the Good Faith Estimate (GFE) under RESPA. The bureau will also release a booklet addressing both Reg. Z and RESPA compliance.

**SAFE Mortgage Act.** The deadline for the Nationwide Mortgage Licensing System and Registry (NMLSR) to register employees of mortgage loan originators (MLOs, including banks) may be delayed for up to a year after the reform act was signed, i.e., until July 21, 2011. The reform act also excludes servicers from the NMLSR registration requirement.

**Credit and debit cards.** Retailers can now offer discounts based on different kinds of payment methods—say, lower prices for using cash rather than a debit or credit card. But they can’t offer discounts across brands—by distinguishing between MasterCard and Visa cards, for instance. Merchants can refuse to take credit cards for purchases of \$10 or under.

**Deposit insurance.** The temporary increases in coverage put in place by the FDIC during the financial crisis will become permanent. Henceforth, up to \$250,000 in qualified deposits will be insured.

**Expedited funds availability (Reg. CC).** The next-day availability amount increases from \$100 to \$200. The \$200 amount will be indexed for inflation every five years (beginning December 31, 2011) and rounded to the nearest \$25.

**Interchange fees.** The Federal Reserve is to set prices on debit card interchange fees (fees charged by card companies to merchants for processing electronic transactions, such as for debit cards). This a controversial provision because the fee standard to be used, “reasonable and proportional to the cost incurred by the issuer with respect to the transaction,” must also consider the cost of protecting consumers against fraud.

**Interest-bearing commercial checking accounts.** One of the more positive product changes in the reform act is enacted by Title VI, which removes the restriction against paying interest on business or commercial checking accounts. ► **Heads-up:** Many sweep arrangements utilized by institutions may no longer be necessary. However, reserve requirements will increase with the larger number of accounts and deposit balances categorized as demand under Reg. D.

**Additional “covered transactions” under Reg. W.** Section 608 amends Section 23A of the Federal Reserve Act (which covers transactions with affiliates) to include under the definition of a “covered transaction” any affiliate transaction that involves credit exposures from repurchase and reverse repurchase agreements, or borrowing or lending of securities or derivatives. The covered transactions must be backed by sufficient capital at all times. These transactions are also treated as extensions of credit for legal lending limit purposes. The rules will be effective July 21, 2011.

### What Other Pertinent Information Should Compliance Professionals Be Aware of?

The reform act strengthened states’ rule writing and oversight authority. The act increases the potential for state intervention in the operations of federally chartered depository institutions by creating new procedural hurdles to preemption determinations and potentially limiting circumstances in which preemption would apply. State law enforcement authorities have been provided statutory authority over federally chartered depository institutions. In addition, state attorneys general can enforce federal consumer laws transferred to the bureau as well as any rules issued by the bureau. ► **Heads-up:** With the increased applicability of state laws for federally chartered institutions, risk management costs may rise substantially, particularly given Congressional interest in heightened consumer protections.

**Early effective dates.** There are a few important changes in the reform act that are effective immediately, two permissive and one punitive:

- National banks and insured state banks are permitted to establish de novo or newly chartered branches in a state other than that in which the organization already has a presence.
- A credit card bank is permitted to make credit card loans to small businesses without losing its “bank” exemption under the Bank Holding Company Act.
- New penalties may be imposed on thrifts that fail to adhere to the qualified thrift lender (QTL) test. This test requires a thrift institution to maintain at least 65 percent of its “portfolio assets” in “qualified thrift investments” (primarily residential mortgages and related investments including mortgage-backed securities) in at least nine of the most recent 12 months.

The reform act also includes other measures outside of regulations to monitor or control compliance-related activities. For example, the act calls for many studies to be conducted by governmental entities. Calling for a study can be one way for Congress to defer acting on an issue until it has sufficient information, and topics to be studied are often subject of future rulemaking. Some of the studies required by the act include the following:

- The feasibility of federal regulation of the insurance sector. The new Federal Insurance Office is required to issue the study within 18 months of the reform act.
- GAO assessments regarding the following:
  - Whether exceptions for nonbanks, savings associations, and credit unions from the Bank Holding Company Act serve to weaken the safety

and soundness of these institutions or the financial system generally. Report due within 18 months of the reform act.

- The effectiveness and impact of appraisal methods and other aspects of the appraisal process. Preliminary report due in 90 days and a study in 12 months of the reform act.
- The need for further protections based on a study of the effects of the federal government in the crackdown on mortgage foreclosure scams and loan modification fraud.
- The prudent statutory and regulatory requirements to provide for the widespread use of shared appreciated mortgages. HUD is required to issue a study with six months of the reform act.
- Bureau studies and regular reports to Congress on issues such as
  - reverse mortgages
  - consumer complaints
  - fair lending enforcement
  - risks faced by consumers
  - certain credit score practices
  - consumer protection for private education borrowers

### What Should You Be Thinking About and Taking Action on Now?

Most of the reform act’s provisions are not effective immediately, which gives compliance officers and others in banking organizations a window to begin their analysis of the act’s implications for their organizations. However, given the reform act’s broad reach and wide range of changes, analyzing the act and creating an action plan early is essential for preparing for the far-reaching and extensive changes that will occur. Planning will require the input and involvement of all business lines, including legal and human resources. Senior management and the board (or committees) should also be involved in this process because the reform act will drive important strategic decisions on corporate structure, expansion plans, product offerings, and organizational resources.

The ABA and other organizations can be excellent sources of information on the details, timing, and implications of the reform act’s many provisions. For instance, see [www.aba.com/aba/documents/RegReform/EffectiveDatesChart.pdf](http://www.aba.com/aba/documents/RegReform/EffectiveDatesChart.pdf) for a tabular report on effective dates. Starting a comprehensive planning process now will ensure that you don’t get killed, but grow stronger as you move into this new regulatory environment. ■

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