

The Wall Street Reform and Consumer Protection Act of 2009

Executive Summary of House Passed Bill

INTRODUCTION

On December 11, 2009, the U.S. House of Representatives approved, by a vote of 223-202, the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173). ABA fought hard to improve the bill and was successful on many fronts in both obtaining key changes to the bill and in keeping out of the bill provisions strongly opposed by the banking industry, such as restrictions on overdraft fees and interchange, usury limits, and bankruptcy cram down. Although some improvements were made, ABA remains opposed to this legislation as passed by the House.

ABA supports broad reform of the banking regulatory system and has expressed this view in testimony before Congress numerous times this year. For instance, ABA has consistently supported the formation of a council charged with overseeing systemic risk, creation of a mechanism for the orderly resolution of systemically important non-banks, and ending too-big-to-fail.

ABA succeeded in preserving all portions of the Home Owners Loan Act as it governs federal savings association charters, in either mutual or stock ownership form, except for consumer protection compliance functions transferred to the new Consumer Financial Protection Agency (CFPA). However, the functions of the Office of Thrift Supervision (OTS) with regard to federal savings associations would be transferred to the Office of the Comptroller of the Currency (OCC) and administered by a Senior Deputy Comptroller designated for that purpose. The functions of the OTS with regard to state savings associations and all Savings and Loan Holding Companies would be transferred to the Federal Reserve.

Although H.R. 4173 contains these elements, and other important reforms, as passed by the House the bill also contains provisions that ABA strongly opposes. In particular, the breadth of authority granted to the Director of the proposed new CFPA is unprecedented, and it separates safety and soundness considerations from consumer protection. ABA has consistently maintained that consumer protection should not be separated from safety and soundness in the regulation of insured depository institutions.

ABA will continue to work with Congress and the Administration on financial services reforms that are needed to protect our economy and consumers, but will oppose provisions that have nothing to do with needed reform and which could make it very difficult for banks to effectively serve their consumer and business customers.

A. Systemic Risk and Dissolution

The bill would create an inter-agency Financial Services Oversight Council that would identify and regulate financial institutions that pose systemic risks. These firms would be subject to heightened oversight and regulation. It also would establish a process for dismantling (dissolving) failing systemically risky firms and require assessments of financial companies with over \$50 billion in assets to pay for a Systemic Dissolution Fund.

Financial Services Oversight Council. The Oversight Council would be composed of 10 voting members (four federal banking agencies, Treasury, the Securities and Exchange Commission, Commodity Futures Trading Commission, National Credit Union Administration, Federal Housing Finance

Administration, and the new CFPA), and three non-voting members (a state insurance regulator, a state banking regulator, and the new Director of the Federal Insurance Office), who are to participate in all meetings and deliberations of the Council.

Accounting. A specific duty of the Oversight Council would be to review and submit comments to the Securities and Exchange Commission (SEC) and any standards setting body (e.g., the Financial Accounting Standards Board) with respect to an existing or proposed accounting principle, standard, or procedure (added by an ABA-supported amendment in Committee by Rep. Ed Perlmutter (D-CO) and Rep. Frank Lucas (R-OK)).

Heightened Standards. The main duty of the Oversight Council would be to identify publicly and subject financial companies to stricter prudential standards if the Council determines that (i) material financial distress at the company could pose a threat to financial stability or the economy; or (ii) the nature, scope, or mix of the company's activities could pose a threat to financial stability or the economy.

Funding. A \$150 billion Systemic Dissolution Fund would be established and pre-funded through assessments on financial companies with \$50 billion or more in assets (adjusted for inflation). If the fund is below \$150 billion, the Systemic Dissolution Authority may borrow funds (up to another \$50 billion) from the Treasury, if necessary, to permit the orderly dissolution of one or more systemically significant financial companies. Companies that manage hedge funds may be assessed if they have \$10 billion or more in assets under management, adjusted for inflation.

TARP Assessment. An amendment was adopted on the House floor authorizing the FDIC to impose a special assessment on all "financial companies" to pay for any shortfall in TARP that would add to the deficit or national debt. A financial company is defined to include bank holding companies (see Section 1602 (9)), but does not include insured depository institutions. The FDIC is authorized to set the amount of the assessment, with the agreement of Treasury and the Fed. How this would work is unclear, but it appears to provide that the FDIC would be able to assess all bank holding companies and other financial companies regardless of size, whether they participated in TARP, or whether the Treasury made a profit from dividends and the sale of warrants to cover losses from non-banks such as car companies. This provision does not apply to insured depository institutions.

Dissolution. At the request of Treasury, the Fed, or the appropriate regulatory agency, the Fed and the appropriate agency can recommend to Treasury that the special dissolution authority in the bill be used instead of bankruptcy. The Secretary of the Treasury, in consultation with the President, will make the ultimate determination to place a company into receivership under these special provisions.

FDIC Assessment Base. The assessment base would be changed from total domestic deposits to average total assets less average tangible equity. The considerations required by statute to be used by the FDIC in its risk-based assessment formula would be modified to include the risks to the deposit insurance fund posed by the *uninsured affiliates* of the depository institution. The FDIC must consider off-balance sheet exposures when setting rates. The current authority to establish separate assessment systems for large and small institutions would be deleted.

Under current law, the FDIC is *required* to pay a dividend to insured institutions when the Deposit Insurance Fund (DIF) exceeds 1.35 percent of insured deposits, and increase the amount of the required dividend when the DIF equals or exceeds 1.50 percent of insured deposits. The bill would provide that the FDIC may suspend or limit the payment of such dividends when the DIF exceeds 1.50 percent, and would delete the requirement to pay any dividend when the DIF is at 1.35 percent.

Risk Retention. The regulatory agencies would be required to adopt joint regulations requiring a creditor or securitizer to retain at least 5 percent of the credit risk and they are prohibited from hedging or transferring the retained risk. The agencies could both reduce or increase the 5 percent requirement depending upon the circumstances.

Secured Lending. The Miller-Moore amendment language reported by Financial Services Committee contained a 20 percent “haircut” for secured lenders. Under the amendment, if the amount of money obtained from the dissolution of a failed systemically risky institution was insufficient to pay back the U.S. government or the systemic resolution fund, the receiver (generally the FDIC) would be authorized to reduce the amount of the security interest in a loan that had been made to the company by up to 20 percent of the remaining balance of the loan when the company was placed into receivership. Revised language was included in the House-passed bill that reduces the amount the security interest in the loan can be reduced (haircut) from 20 percent to 10 percent. The amendment is also intended to limit the haircut to short-term loans (30-days or less). Loans secured by government-issued or guaranteed instruments and loans secured by GSE securities (such as Fannie mortgage-backed securities) are also exempt. Secured loans made to insured depository institutions are exempt from the haircut.

B. Consumer Financial Protection Agency

The bill would create a new federal government agency called the Consumer Financial Protection Agency (CFPA) dedicated to consumer financial product regulation. The CFPA would have sweeping rulemaking, supervision, and enforcement authority over virtually all consumer financial activities by banks and non-bank financial institutions, with certain exceptions. It also would make changes to federal preemption of state consumer laws for national banks and savings associations.

Director/Commission. The CFPA would be led by a Director appointed by the President for the first two and a half years of its existence. After that, a five-member Commission would take over. The Chair of the Commission would initially be the Director, and the other four members would be appointed by the President.

Consumer Laws. Oversight over most consumer protection laws (except the Community Reinvestment Act) would be transferred from the prudential regulatory agencies to the CFPA 180 days after the bill is enacted into law.

CFPA Jurisdiction. The jurisdictional reach of the CFPA would be very broad and it would have oversight over any entity (with certain exceptions) that is engaged in selling or providing a financial product or service. Unfortunately, an ABA-supported amendment by Rep. Walt Minnick (D-ID) that would have created a council made up of the prudential regulatory agencies – instead of the CFPA – to write consumer protection rules failed, by a 223-208 vote. House leaders strongly opposed the amendment, which they considered a “poison pill” that would have derailed the entire legislation. ABA will work hard in the Senate to remove or substantially alter the CFPA provision.

Exceptions to CFPA Oversight. The bill is intended to provide uniform oversight and enforcement of consumer protection laws, but that is far from the case. CFPA’s jurisdiction specifically does not include general insurance products and services regulated by the states, securities products and services regulated by the SEC, any entity regulated by the CFTC, and any entity regulated by the Farm Credit Administration.

In addition, one of the main goals of the CFPA as originally conceived was to regulate non-banks that are lightly regulated by the states. Although non-banks would be required to register with the CFPA, they would be subject only to “risk-based” examination rather than the regular and intensive examinations

applied to insured depository institutions. There are real questions and concerns about how effectively this can be implemented.

Moreover, several other specific exceptions are provided for non-bank entities that have been either directly or indirectly involved in providing financial services products and services. Some of these include exceptions for retailers, merchants, and other sellers of non-financial products to the extent they are not engaging in financial activities. There also would be similar exceptions for real estate brokers, accountants, tax preparers, pawnbrokers, and attorneys. Auto dealers and credit reporting agencies also would be exempt from CFPA oversight. Qualified retirement or eligible deferred compensation plans are also excluded, but bank trust operations do not appear to be excluded.

Many of the institutions excluded from CFPA oversight compete directly with banks, especially with smaller banks and other financial institutions.

Specific CFPA Consumer Protection Authority. The CFPA would be the sole rule-writing federal agency for consumer protection provisions applicable to banks and credit unions. Although CFPA would not have explicit authority to establish standardized or “plain vanilla” products, it would have very broad powers, including:

- Issuing rules prohibiting “unfair, deceptive, or abusive acts or practices.”
- Establishing new rules for disclosures. The standard is very broad – “to ensure the timely, appropriate, and effective disclosure to consumers of the costs, benefits, and risks associated with any consumer financial product or service.” The CFPA may draft model disclosures which, if used, would constitute *per se* compliance with a covered person’s disclosure obligations.
- Issuing rules regarding sales practices and the “manner, setting, and circumstances” of those practices, to ensure that the risks and benefits of products and services are fully and accurately represented to consumers.
- Establishing “fair dealing” duties for employees and agents of covered persons that communicate directly with consumers, and to establish rules for compensation of such persons to promote “fair dealing with consumers.”
- Restricting mandatory pre-dispute arbitration with respect to a consumer product or service.
- Issuing rules regarding custody and investment management accounts, and potentially over trust accounts that are not “in compliance with the applicable law.”

Smaller Insured Depositories. The CFPA would be authorized to write consumer protection rules for all banks and credit unions. However, the bill also provides that banks and credit unions with up to \$10 billion in total assets would be subject, at least initially, to consumer protection examination and enforcement by their prudential regulatory agencies. The “exception” in the bill for smaller institutions is illusory:

- Although the appropriate federal banking agency, rather than the CFPA, would conduct consumer protection compliance examinations for depository institutions with total assets of \$10 billion or less, the CFPA would have the right to include one of its examiners on the examination team.

- The appropriate federal banking agency, rather than the CFPA, would have primary authority to take consumer related enforcement actions against depository institutions with total assets of \$10 billion or less. However, the CFPA may recommend that the primary agency take an enforcement action, and if such action is not taken, the CFPA may proceed with the enforcement proceeding.
- If the CFPA has reasonable cause to believe, through complaints by consumers, that a depository institution with \$10 billion or less in total assets is not in compliance with applicable consumer laws under the CFPA's new jurisdiction, the CFPA may directly investigate and take enforcement actions against that institution.
- If the CFPA determines that one of the appropriate agencies has failed to adequately conduct consumer compliance examinations of an institution with \$10 billion or less in assets, the CFPA may order the "removal" of the banking agency. The Secretary of the Treasury would determine if the removal is to be upheld.

CFPA Funding. CFPA would be funded through a transfer of funds from the Federal Reserve System in an amount equaling 10 percent of the Federal Reserve System's total system expenses, and by fees assessed on "covered persons." The amount of the fees would be based on the "size and complexity of risk posed by the covered person and the compliance record of the covered person." However, for the first three years after enactment no bank or credit union would pay more for supervision – combined consumer compliance and prudential – than it paid before the enactment of the CFPA. Banks and credit unions with greater than \$10 billion in assets would be assessed for the cost of their supervision by the CFPA.

Preemption. A Manager's amendment adopted by the House restores some preemption for national banks and savings associations that the original CFPA proposal took away. Specifically, the language provides that state laws that "prevent, significantly interfere with, or materially impair" the ability of national banks (or state banks in states with wild-card statutes) to engage in the business of banking may be preempted. The same standard would apply to federal savings associations. Although there continue to be problems with this language, it is closer to embodying fully the preemption standards set forth in the Barnett Bank case. ABA has been working for several months to secure a preemption agreement that is positive for all banks and believes the new provisions are an improvement from where the process started.

Enforcement of Consumer Protection. The CFPA and the states would have broad enforcement authority. Although existing private rights of action contained in consumer laws transformed to the CFPA would continue, any rules issued under the new authorities contained in the bill would not give rise to new private causes of action. CFPA would have administrative enforcement authority over anyone covered by the laws it implements, including insured depository institutions and other firms not now subject to "comprehensive federal supervision."

C. Executive Pay

The bill would impose new disclosures and limitations on executive compensation.

Say on Pay. All public companies would be required to provide shareholders with a non-binding vote regarding executive compensation.

Compensation Committee. All companies listed on an exchange would be required to have a compensation committee composed solely of independent directors.

Compensation Plans. The federal banking regulators, the SEC, and the Federal Housing Finance Agency (FHFA) would be required to jointly issue regulations prohibiting any compensation package that encourages executives to take risks that could seriously affect the economy or threaten the safety and soundness of financial institutions. Covered financial institutions would have to make disclosures to the regulators about their compensation plans. Institutions with assets of less than \$1 billion would be exempt from these requirements.

D. Other Regulatory Restructuring

Several of the titles in the bill include regulatory restructuring provisions which appear to have very little to do with consumer protection or systemic risk. Some of these provisions are highlighted below.

Savings Associations. The thrift charter and those portions of HOLA governing the charter would be preserved, but functions of the OTS relating to federal savings associations (other than consumer protection) would be transferred to the OCC. In lieu of the Director of OTS, the Fed would have a seat on the FDIC Board. Supervision (other than consumer protection) of state-chartered savings associations and all savings and loan holding companies and their subsidiaries would be transferred to the Fed. Mutual holding companies organized under section 10(b) of HOLA that have sold minority shares of stock prior to December 1, 2009, may continue to waive dividends and will not have any of their waived dividends considered in determining the appropriate exchange ratio in the event of full conversion to stock form.

Interstate Branching. Both national banks and state banks would be able to branch “de novo” across state lines and open branches in another state, to the same extent that banks chartered in the second state may establish branches under state law. Since ILCs are insured state banks, they also would be able to de novo branch across state lines.

Business Checking. The bill was amended on the House floor to remove the prohibition against paying interest on demand deposits. The effective date of this provision would be one year after enactment.

SOX Exemption. As reported by the Financial Services Committee, the bill exempted smaller public companies from the Sarbanes-Oxley Act’s external audit of internal controls requirement. The House defeated, in a 271-153 vote, an amendment strongly opposed by the ABA that would have eliminated this provision. ABA, which was instrumental in obtaining Section 404 compliance extensions for small companies, strongly supports this relief because the cost of compliance for small public banks has been disproportionately higher than for larger institutions.

E. Mortgage Lending

No Mortgage Cram Down. An amendment was offered on the House floor that would have allowed bankruptcy judges to reduce the outstanding balance (cram down) on a mortgage loan, to freeze or lower the interest rate, or extend the term of the loan. It failed by a vote of 241-188 – thanks to an outpouring of opposition by ABA, state associations, and grassroots bankers.

Previous House Bill Included. The bill includes substantial portions of H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, which the House passed on May 7, 2009. These provisions would create loan origination standards, ban yield spread premiums, create new lender liabilities, ban mandatory arbitration provisions in mortgage loans, lower the HOEPA trigger, and make several changes in mortgage servicing and appraisals, among other things.

F. Securities – Derivatives

The bill would impose sweeping new regulation of the over-the counter (OTC) derivatives markets. For the first time, the OTC derivatives markets, OTC derivatives dealers, derivatives clearing organizations and agencies, swap repositories, swap execution facilities, and major non-dealer participants would be subject to comprehensive regulation.

It would generally impose position limits for physical commodities, transparency of offshore trading, clearing, exchange trading, reporting, capital, margin, and recordkeeping requirements on OTC participants. It also would create a more regulated, burdensome, and costly environment for participants in the OTC derivatives markets.

The bill would amend the Investment Advisers Act of 1940 to expand SEC oversight over hedge fund advisers and others. For instance, advisers to hedge funds worth over \$150 million generally would be required to register with the SEC as investment advisers and to disclose financial data for systemic risk purposes.

It also would impose new rules for credit ratings agencies that are intended to reduce conflicts of interest, reduce the reliance of the market on credit rating agencies, and impose penalties for non-compliance.

Additional investor protections would be required, including increased fiduciary standards for broker-dealers and registered investment advisers and increased SEC investor protection oversight and enforcement.

G. Insurance Regulation

The bill would create the Federal Insurance Office (FIO) within the Department of the Treasury. The FIO would have limited preemption powers. It could preempt state insurance laws that conflict with international insurance agreements and result in the less-favorable treatment of a non-United States domiciled insurer than a state domiciled insurer. The Director would be required to submit to Congress every year a list of state laws preempted.

The FIO would be authorized to collect data and information from the insurance industry and would be required to conduct a study and report on the insurance industry within 12 months of enactment. That study would focus on ways to modernize and improve U.S. insurance regulation.

The bill also would direct the FIO to examine any legislative, administrative, or regulatory proposals that would modernize or improve the system of insurance regulation.