Dodd-Frank and Community Banks: Your Guide to 12 Critical Issues

ABA prepared this guide, which highlights 12 of the most important Dodd-Frank issues that will see action in 2012, to help community bankers prepare for, respond to and manage regulatory pronouncements that could have a significant impact on their institutions.

Each issue page includes sections on why it matters, what to watch out for and—most important of all—how bankers can get involved to influence the outcome. A list of ABA resources that can help bankers track and analyze the issues and tackle some of the compliance challenges associated with them is also included, in addition to a listing of staff issue experts for all Dodd-Frank issues. As always, ABA encourages bankers with questions or concerns to contact the issue expert on staff, as indicated on each issue page.

Keep abreast of the latest developments for these 12 issues and all of the other Dodd-Frank changes through ABA’s Dodd-Frank Tracker, the industry’s leading resource on this legislation.

We are especially grateful to six community bankers for their review and comments on this guide:

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About American Bankers Association

The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s $13 trillion banking industry and its two million employees. The majority of ABA’s members are banks with less than $165 million in assets. ABA’s extensive resources enhance the success of the nation’s banks and strengthen America’s economy and communities.

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The capital changes under the Dodd-Frank Act bring the United States close to convergence with the international capital standards outlined in Basel III. Public statements from U.S. bank regulators confirm their intention to harmonize U.S. regulations with international standards, and even exceed them. Although the changes under Dodd-Frank apply mostly to large institutions, Basel III requirements will likely apply to all banks. ABA anticipates comprehensive revisions to the risk-based and leverage capital frameworks as a result of Dodd-Frank and recent pronouncements from the Basel Committee.

**WHY IT MATTERS**

The advocacy challenge is to sensibly dial back capital requirements while ensuring stable sources of capital. This challenge is real and ongoing. Every indicator in the regulatory and legislative spheres—as well as public sentiment—points to requiring more bank capital.

**GET INVOLVED**

- **Participate in ABA working groups.** ABA forms a working group on each capital rulemaking proposal to develop an industry position and provide comment. Look for notices in ABA Daily Newsbytes.

- **Engage with ABA to advocate for all U.S. banks on the international stage.** ABA aggressively monitors and comments on international proposals issued by the Basel Committee. These proposals often serve as a base for U.S. rulemaking.

- **Participate in pre-rulemaking advocacy.** After Basel international standards are set, but before U.S. rulemakings adopt the international standard, ABA actively engages U.S. regulators on key issues.

- **Keep up to date.** As the banking agencies overhaul the capital rules, ABA will raise awareness about developments through telephone briefings, ABA Daily Newsbytes and fielding your questions at 1-800-BANKERS.

- **Tell us your concerns.** We want to hear about how your bank is addressing capital concerns. Send your feedback to Hugh Carney or Helen Sullivan.

- **Join the Capital Markets Working Group.** This group focuses on the market conditions community banks are experiencing and the effect on banks’ access to capital. Contact Helen Sullivan for more information.
**WHAT TO WATCH OUT FOR**

**Credit Ratings Replaced by Formulaic Approach in Risk-Based Capital**
Dodd-Frank requires federal regulators to review and remove references to credit ratings (Section 939A) for all regulations. This has huge potential consequences, as existing capital rules rely heavily on external credit ratings. Ratings requirements are incorporated in Basel I, treatment of securitizations, Basel II (advanced and standardized approaches) and the market risk rule.

**Narrower Definition of Capital**
Basel III defines regulatory capital more narrowly through explicit standards for Tier 1 common equity capital. ABA expects the new definitions of capital to be applied to all U.S. banks.

**Greater Volatility in Regulatory Capital Measurement**
The Basel III definition of capital includes unrealized gains and losses on available-for-sale securities, which could greatly increase the volatility of an bank’s regulatory capital measure.

**Tier 1 Minimum Ratios Raised as High as 9.5 Percent**
Basel III also increases the minimum risk-based capital ratios. ABA expects a 2012 U.S. proposal—applied to all U.S. banks—that will mirror Basel III and will increase Tier 1 common equity requirements for banks to as high as 9.5 percent. ABA expects these requirements to be applied to all banks, particularly since section 616 of Dodd-Frank requires that regulators “seek to” make capital requirements countercyclical.

**Higher Capital Requirements for Certain Types of Bank Exposures**
Certain types of bank assets will be subject to greatly increased capital requirements when the U.S. adopts Basel III. These exposures include securitizations, trading assets, derivatives and exposures to large banks. ABA is expecting some of these treatments to be applied to all U.S. banks.

**Through Examinations, Certain Banks Will Need to Hold Above the Minimum**
Even while regulators are raising the minimum capital levels for all banks, ABA expects regulators to continue to demand even higher capital levels at certain banks.

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The Dodd-Frank Act created the CFPB, a massive new agency with unprecedented rulemaking and enforcement power intended to identify and address perceived failures in consumer protection and to strengthen regulatory oversight of non-bank providers of consumer financial products.

**WHY IT MATTERS**

The CFPB and other empowered agencies will impose daunting new compliance, operational, and recordkeeping burdens on all banks. These new requirements will make it significantly harder for banks, particularly community banks, to serve their communities and help grow the economy.

The new rules and recordkeeping requirements will create pressure to hire additional compliance staff instead of customer-facing staff. It will also mean more money is spent on outside lawyers and consultants, reducing resources that could be directly applied to serving a bank’s customers and community.

**GET INVOLVED**

- **Support Congressional efforts to ensure accountability and oversight of the CFPB**, including replacing the director with a five-member, bipartisan board and amending the standard for review of CFPB rules.

- **Be engaged with the Bureau at each step.** ABA representatives attend Bureau outreach meetings and are active participants in regulatory reform discussions. Bankers have been and will be called on to be directly involved. If you want to participate, contact Ginny O’Neill.

- **Promote interagency consistency** in enforcing clear rules and applying uniform supervisory expectations. Push back against prudential regulator consumer protection theories that result in double jeopardy for community banks.

- **Have your voice heard by participating in panels convened to consider the impact of proposed rules** on small banks and the availability of credit. Dodd-Frank requires CFPB to assemble Small Entity Representatives (SERs) for participation on Small Business Regulatory Enforcement Fairness Act (SBREFA) panels. More information is available at aba.com/compliance.

- **Encourage a balanced point of view by engaging other allies** so that the public policy dialogue is not dominated by consumerist organizations. ABA has formed a Bank UDAAP Counsel group to share experiences and help members guide the development of the new “abusive” standard.
WHAT TO WATCH OUT FOR

New Rules Written by the CFPB
The Bureau will now make rules for 17 enumerated consumer laws—seven of which are expressly banking laws—and the rulemaking process has already begun. This expansive rule-writing authority will be exercised by a single director over all banks, large and small, and will touch all consumer financial services and products. There is no community bank exemption from the Bureau’s rule-writing power.

Double Jeopardy for Community Banks
Banks are now subject to overlapping rules. Banks may follow the Bureau’s rules but still be cited by a prudential regulator for matters requiring attention in such areas as debit card overdraft, direct deposit advance and rewards checking.

New Powers for State Attorneys General
Dodd-Frank enables state AGs to enforce federal consumer financial protection laws against community banks. In addition, Dodd-Frank permits only the Bureau—not a prudential regulator—to intervene in an AG-initiated enforcement action.

New Costly Record-Keeping and Reporting Requirements
The Bureau has broad authority to require reports or “other information” from any bank at any time. In addition, the Bureau will require banks to compile and report additional HMDA data and HMDA-like small business loan data. Finally, all banks will be required to provide customers with expanded access to account, transaction, and fee information.

New Product Regimentation
Banks will find it much more difficult to tailor loan and deposit products to their customers, since the Bureau will favor standardized “plain vanilla” products as it pursues disclosure simplification. The Bureau has already demonstrated this bias through the initiation of “Know Before You Owe” projects like the announcement of a model credit card agreement.

The New UDAAP Standard
The Bureau will have broad authority to curb practices it finds to be unfair, deceptive and abusive. Unless the Bureau abides by the bedrock premise that consumers are responsible for their decisions, what constitutes “abusive” behavior may be very broadly applied and is very likely to create an environment conducive to increased litigation. This will be exacerbated by the fact that prudential regulators will allow their own examiners to invent their own theories about what constitutes an unfair, deceptive or abusive act or practice.

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FDIC Coverage and Assessment Base

The Dodd-Frank Act made significant changes to how the Federal Deposit Insurance Corporation is funded and how large the deposit insurance fund can be. It raises the insurance limit to $250,000, making up for the impact of inflation since 1980 when the $100,000 limit was set. It also gave the FDIC responsibility for resolving large, systemically important banks, which broadens the agency’s mission dramatically beyond providing insurance to depositors. It also attempts to deal with the “too big to fail” problem. Because additional revenue to the FDIC counts as revenue for the federal budget, Congress used these provisions to “pay for” costly provisions elsewhere in Dodd-Frank, setting a terrible precedent to use premiums as a source of revenue for other government spending programs.

**WHY IT MATTERS**

Most community banks saw a reduction in premiums from the expansion of the assessment base (less so for those banks that use Federal Home Loan Bank advances) as the largest banks began to shoulder a greater portion of total FDIC assessments in 2011. Other FDIC changes were not positive for community bankers, including the elimination of the hard cap on the size of the fund—which will mean high premiums for years to come.

**GET INVOLVED**

- **Be actively involved in the FDIC’s new study on the future of community banks** by attending regional meetings and commenting on various ideas. ABA will be engaged through many channels, including the ABA Chairman’s Regulatory Relations Task Force. To get involved, contact Wayne Abernathy at wabernat@aba.com.

- **Remind Congress that banks, not taxpayers, are the sole source of FDIC funding.** The deposit insurance fund needs to be rebuilt and now there is no limit to its size. How fast it is rebuilt is a critical policy question, as there is an important trade-off between another dollar in reserves for failure costs versus that dollar used to provide financial services in communities. Every dollar of bank capital supports up to $10 in loans.

- **Join the fight against using the FDIC fund as a source of revenue for non-FDIC government programs.** Such a use would undermine the integrity of the insurance assessment process and could ultimately undermine depositor confidence in the FDIC, as the fund will be seen as a political fund to be exploited for other purposes.
WHAT TO WATCH OUT FOR

Premiums Will Stay the Same in 2012 (and Well Beyond 2012)
Premiums will stay at their current levels (assuming no change in the risk-profile) until the insurance fund reaches 1.15 percent, likely around 2017.

Full Coverage of Non-Interest Bearing Transaction Deposits Expires at Year-End 2012
Dodd-Frank extended full coverage of non-interest bearing transaction deposits and interest on lawyers trust accounts (IOLTAs) for two years to help community banks retain deposits in the weak economy. Extending this beyond 2012 would require legislation and the full support of the FDIC.

No Limit on the Size of the FDIC Fund
Expect premiums to remain at elevated levels even until the fund exceeds 2 percent of insured deposits—expected in 2025—because Dodd-Frank eliminated dividend payments to slow the growth of the insurance fund and eliminated the hard cap (1.5 percent) on the size of the fund. In addition to the target reserve ratio of 2 percent, the FDIC expects to set premiums at a level to grow the fund beyond 2.5 percent. A 2 percent fund today would be a $136 billion fund—$128 billion above the current balance—all counting as federal government revenue.

Minimum Level for the FDIC Fund Increased from 1.15 Percent to 1.35 Percent
Banks over $10 billion in assets are required to make up the gap from the old minimum of 1.15 percent to the new minimum of 1.35 percent, which benefits smaller banks. However, smaller banks would continue to pay premiums during this period. The FDIC will propose a method for this gap-funding by larger banks in the next 18 months. All banks would be required to keep the fund above the minimum and at the new designated reserve ratio of 2 percent once that level has been achieved.

The Savings from the Broadened Assessment Base May Be Short-lived
The new broadened assessment base adds a new premium cost to nondeposit liabilities (e.g., FHLB advances), thus making them relatively more expensive. A small rise in deposit pricing (a natural consequence of relative price changes) of only five basis points would wipe out the typical savings from the broadened assessment base.

Interest Paid on Business Checking Accounts Allowed
Dodd-Frank removed the prohibition on paying interest on business DDAs effective July 2011. This could raise costs, particularly after the full coverage for transaction accounts expires at year-end. The current low interest rate environment may delay any significant impact until interest rates begin to rise.

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Virtually every rule and requirement applicable to mortgage finance will be amended or transformed under the Dodd-Frank Act. The many modifications introduced by Dodd-Frank are interspersed across various sections of this legislation and will require extensive rulemaking—and related compliance burden—for years to come.

The reforms to mortgage lending encompass broad new restrictions on lending practices and loan terms, amend price thresholds for certain lending segments, add new disclosure forms and procedures for all mortgages, and mandate stronger legal liabilities in connection with real estate finance.

**WHY IT MATTERS**

This legislation represents an unprecedented rewrite of the legal regime covering mortgage finance issues. The reforms are so comprehensive that they will require full-scale transformation of mortgage lending systems and processes. Some banks will evaluate whether to continue to make mortgages, because these changes will require burdensome implementation efforts and increased regulatory guidance from federal agencies. Under many provisions, regulators are afforded wide latitude in defining the shape and scope of the rules, so much detail is left undetermined.

In the coming months, banks must prepare for intense regulatory activity affecting mortgages. Banks must carefully plan the resources necessary to confront the workloads that will be required to revamp their mortgage lending operations as these reforms become finalized.

**GET INVOLVED**

- **Engage with ABA** in all aspects of the agencies’ implementation rulemaking.

- **Stay tuned into ABA information resources.** ABA will issue summaries and analyses of all regulatory developments in ABA Daily Newsmets and on the Dodd-Frank Tracker at [regreformtracker.aba.com](http://regreformtracker.aba.com). ABA will also organize educational programs to ensure that members understand all requirements. Visit [aba.com/teleweb](http://aba.com/teleweb).

- **Participate in ABA working groups.** Ensuring proper and orderly implementation is a high priority, and ABA will form working groups and organize compliance and advisory calls as necessary. Contact Rod Alba or Joe Pigg to get involved.

- **Keep ABA informed** of issues that arise as you make changes in your mortgage programs to address Dodd-Frank requirements in your bank by contacting Rod Alba.
WHAT TO WATCH OUT FOR

Changes to MortgageDisclosures
Dodd-Frank requires the Consumer Financial Protection Bureau to integrate the mortgage disclosures required by the Truth in Lending Act and the Real Estate Settlement Procedures Act. Integration has the potential to streamline and simplify the bewildering system of mortgage forms. However, integration will alter all disclosure rules applicable to residential mortgage lending. Expect issuances of proposed rules, followed by final rulemaking, in the next 9 to 24 months.

Further AppraisalReforms
Dodd-Frank adds new provisions to promote the accuracy and independent judgment for appraisals performed in dwelling-secured loans. Rules to implement these provisions were issued as interim regulations in October 2010 and are fully effective for all banks currently. Expect further amendments correcting various elements of the law in the coming months.

EscrowAccountRequirements
There are pending rulemakings to implement requirements for mortgage-related escrows under Dodd-Frank. Current efforts deal with such issues as thresholds, used to determine whether lenders are required to establish escrow accounts on certain mortgage loans, new disclosure requirements to better inform consumers of their rights, and certain special escrow provisions for lenders operating in rural and underserved areas.

Restrictions onLoanOriginatorCompensation
Dodd-Frank codified certain Federal Reserve regulations issued in 2010 that imposed restrictions on compensation paid to mortgage loan originators. These rules are complex and ambiguous. More rulemaking is expected on these items over the coming year.

AdditionalGovernmentReportingRequirementsUnderHMDA
Dodd-Frank amends the Home Mortgage Disclosure Act to significantly augment mortgage lending information that must be reported to the federal government. New items to be reported include credit scores on loans originated, value of the property securing the loan, and age of borrowers or applicants. Since this information will be publicly available, banks will be subject to increased scrutiny and criticism of lending behavior. The obligation to comply with these expanded reporting requirements is awaiting rulemaking.

NewHOEPARequirements
Dodd-Frank amends the calculations for determining whether loans are subject to special high-cost loan protections. New rules, yet to be implemented by regulation, will mandate increased counseling for higher-cost loans and additional restrictions on loan terms.

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Housing: QM and QRM

The Dodd-Frank Act dramatically impacts the willingness and ability of community banks to make mortgage loans. It imposes broad risk retention requirements on most loans sold into the secondary market and requires lenders to show that borrowers met an “ability to repay” test—which can be challenged in court for the entire life of the loan, raising the risk of litigation tremendously.

Dodd-Frank provides exceptions to some of these requirements. The Qualified Mortgage (QM) is intended to be a category of loans with characteristics that are deemed to meet the ability-to-repay test. It is unclear if the QM will provide a safe harbor against legal challenge or only a “rebuttable presumption,” which can be challenged in court. The Qualified Residential Mortgage (QRM) provides exceptions to risk retention requirements. How these exceptions are defined is currently being developed by the regulators.

**WHY IT MATTERS**

The QM and QRM rules will reshape mortgage lending, changing what loans are made and by whom. Most lenders will not want the financial or reputational risk associated with loans outside the QM designation and will simply not make loans that are not Qualified Mortgages. The proposed QRM takes most underwriting decisions away from the lender and requires a “check the box” approach that will make many current loan products impossible to offer or undesirable due to cost and risks involved.

Some community banks may stop providing mortgages altogether as the requirements and compliance costs make such a service unreasonable without considerable volume.

**GET INVOLVED**

- **Raise concerns and objections to regulators and Congress.** Even though the comment period has closed for both rules, you should continue to raise concerns and objections to the CFPB for QM and the bank regulators for QRM. Congress needs to hear this, too. Explain how the proposed rules can hurt your ability to lend and your customers’ ability to get responsible credit.

- **Let CFPB know that the QM must have a “safe harbor.”** If there is to be any tangible benefit, a safe harbor is a must; without it, underwriting will become so restrictive that few borrowers will qualify for credit.

- **Tell the bank regulators that the 20 percent QRM down payment requirement will put homeownership out of reach of most borrowers.** Let them know that the proposed QRM takes legitimate underwriting tools like credit scores away from banks’ decision making process.

- **Stay tuned to ABA for developing news on both rules.** As rules are finalized or reproposed, ABA will keep you informed and provide analysis of the new developments. ABA will also provide educational programs to ensure members understand new requirements as rules are finalized.
WHAT TO WATCH OUT FOR

Mortgage Credit Will Be Curtained
The QRM, if implemented as currently proposed by the regulators, will require a minimum of 20 percent down from borrowers and nearly spotless credit histories. Loans not meeting QRM requirements will be more expensive to offset the risk retention required.

Potential Reproposal of QRM
The initial QRM proposal was so narrow that even members of Congress who drafted the QRM concept said it was too restrictive. We expect the banking agencies to revise the proposal and republish a revised rule sometime in 2012.

Ability to Access the Secondary Market Could Be Curtained
Loans that do not meet the QRM will be subject to risk retention requirements and will be harder to sell into the secondary market—especially any non-GSE secondary market.

Final QM Rule from the CFPB
The CFPB has been tasked with finalizing the QM rule. Key to the rule will be whether the QM provides a “safe harbor” against ability-to-repay challenges, or only a “rebuttable presumption.” If the rule only provides a presumption, then costly litigation is likely, as well as reduced credit availability and more expensive products for those who do qualify.

Lenders’ Liability Will Increase
Borrowers can raise ability-to-repay challenges for the life of the loan, increasing the potential liability for lenders—failure to prove ability to repay can result in reimbursement of all payments made by a borrower. Loans will be more expensive to offset added liability risk.

Fannie and Freddie Exempt from QRM
Fannie Mae and Freddie Mac are both exempt from risk retention requirements, which will likely drive the market even more toward the GSEs. This will complicate efforts to restructure the GSEs in the future.

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Interchange

The Dodd-Frank Act’s Durbin Amendment required the Federal Reserve to regulate debit interchange fees and how transactions are routed from merchants to card issuers. The Fed’s rule, finalized June 2011, decreased interchange fees far below rates set by the marketplace. Rates are now composed of a base fee of 21 cents per transaction and five basis points to cover fraud losses. An interim rule would allow an additional one cent per transaction to cover fraud prevention efforts. Price caps apply to all debit cards issued by banks with assets greater than $10 billion.

The new rule also prohibits network exclusivity arrangements on debit cards, which allowed banks to negotiate more favorable terms. The rule requires issuers make two unaffiliated networks available without regard to the method of authentication (PIN or signature). All banks must meet these requirements.

WHY IT MATTERS

This rule directly inserts the government into a price-fixing role, mandating competitive inequities in the marketplace. The price cap means a significant cut in bank revenue—approximately $6.6 billion or a 45 percent loss in revenue—that banks use to provide low-cost accounts, fight fraud and maintain an efficient U.S. payments system.

Exempting community banks from the interchange requirements will not work. Simply put, it is unsustainable for two firms to offer the same product at radically different prices. Any price control creates unintended consequences, market distortions and higher costs for others, including consumers.

All banks must comply with the new routing and exclusivity agreements. Banks that do not currently meet this standard will have to renegotiate network agreements and add unaffiliated networks as a routing option on their cards. This will add costs to the banks who issue the cards.

GET INVOLVED

- **Fight against legislative or regulatory attempts to expand** the provisions of the Durbin Amendment affecting debit cards or reaching further to affect credit cards.

- **Report to ABA on the effect of the Durbin amendment** on your card programs and your customers.

- **Monitor and report to ABA about merchant compliance with the rules** that prohibit them from refusing to accept community bank-issued debit cards.

- **Participate in ABA grassroots efforts to persuade the Fed** to consider all of the allowable costs associated with fraud prevention to be incorporated into the price caps. Visit aba.com/grassroots.

- **Join the ABA Payment Systems Open Committee** to pursue prudent payment system policies on debit cards and all payment channels. Contact Steve Kenneally for more information.
WHAT TO WATCH OUT FOR

Steering By Merchants away from Community Bank Debit Cards
While the Durbin Amendment technically applies only to banks over $10 billion, market forces will drive business to the lowest cost option and community bankers will feel the impact. Merchants—especially big box retailers—have an incentive to encourage consumers to use only debit cards offered by large banks, prompting them to move their checking accounts and maybe even sever the relationship they have with their local bank.

Final Rule on Fraud Costs
The interim rule correctly requires issuers to meet flexible, nonprescriptive fraud prevention standards in order to receive a fraud prevention adjustment. The one-cent adjustment, however, is insufficient to cover the true costs that issuers bear to quickly respond and prevent new types of fraud. ABA believes the true costs should be at least 4 to 5 cents per transaction. The Fed will issue a final rule at any time.

Continued Congressional Interest
Over the past year, the battle over debit card interchange has had a very high profile on Capitol Hill. Every member of the House and Senate was subject to intense lobbying from bank and merchant constituents. Some members of Congress may seek to increase the burden of the Durbin Amendment on debit card issuers or even expand some restrictions to credit cards.

Lawsuit by Retailers over Debit Card Interchange Rule
A coalition of retailers and trade associations filed a lawsuit on November 22, 2011, in U.S. District Court in Washington, D.C., over the Fed's Debit Card Interchange Fee Rule. The complaint alleges that the Fed's interchange rule ignores the statutory direction of the Durbin Amendment that any debit interchange fee “is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.”

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Section 975 of the Dodd-Frank Act was intended to establish a regulatory framework for unregulated persons providing advice to municipalities on areas such as municipal derivatives, the issuance of municipal securities and “investment strategies.” The registration rule proposed by the Securities and Exchange Commission has defined investment strategies broadly to include any funds “held” by a municipal entity, regardless of whether such funds are related to the issuance of municipal securities or the investment of bond proceeds. This definition could cover traditional bank products and services, such as deposit accounts, cash management products and loans to municipalities.

**WHY IT MATTERS**

The SEC’s registration proposal would add an unnecessary layer of regulation on day-to-day bank services and products. There would be a new registration scheme for most banks and many of their employees with two new regulators, the SEC and the Municipal Securities Rulemaking Board (MSRB). There would also be an additional layer of record-keeping and conduct requirements imposed on top of existing bank product and service regulation. The proposal would cover bankers who are appointed to municipal boards, such as city budget committees. The consequences could be severe:

- Local community banks might not take municipal deposits if they have to deal with the costs and burden of registration, meaning that local governments, schools, libraries, etc., will have to go outside their communities for bank accounts.
- Bankers may decline to offer covered opinions or advice, or may even decline to serve on local government boards rather than have to register.

**GET INVOLVED**

- **Ask your representatives to support Congressman Dold’s bill, H.R. 2827, in the House and Senator Toomey’s bill, S. 1824, in the Senate.** Both measures provide a complete exclusion for banks from municipal advisor regulation. Use ABA’s Talking Points to make your case. Visit aba.com/Press+Room.

- **Engage with ABA in opposing the SEC proposal.** ABA has advocated our position with SEC Chairman Schapiro, SEC staff, bank regulators, congressmen and senators, and we have worked with state banking associations and bankers to write open letters to the SEC in opposition to this proposal.

- **Tell us your concerns.** Contact Cristeena Naser or Phoebe Papageorgiou with information about how the rule is being implemented in your jurisdiction.

- **Follow ABA updates on the issues.** ABA will keep members updated on the status of the SEC proposal and advocacy efforts through ABA Daily Newsbytes and through the Dodd-Frank Tracker at regreformtracker.aba.com.

- **Get involved in grassroots** by contacting your members of Congress and other policy makers to be sure they understand why this matters to community banks. Visit aba.com/grassroots.
WHAT TO WATCH OUT FOR

Final SEC Rule to Define “Municipal Advisor” Expected by September 30, 2012

The final SEC registration rule will define “municipal advisor.” If banks and their employees are considered municipal advisors because they provide “advice,” an undefined term, they will have to register with both the SEC and the MSRB and would be subject to MSRB rules governing conduct, recordkeeping and reporting requirements. This would have several consequences:

• **New Fiduciary Duty to Municipalities**
  Banks and their registered municipal advisor employees will have a fiduciary duty to municipalities, if they are required to register as municipal advisors.

• **New Pay-to-Play Restrictions Would Require Monitoring**
  Banks and their registered municipal advisor employees will be subject to pay-to-play restrictions if they are required to register as municipal advisors, which would require a process to monitor employee and officer contributions to state and local government officials.

• **Duplicative Regulation of Traditional Bank Products**
  Banks will be subject to a new layer of securities-based regulation on traditional bank products and activities if they are required to register with the MSRB. Banks are already subject to close supervision by bank regulators. This would result in a significant and unnecessary burden on community banks and could give rise to the potential for conflicting regulatory mandates.

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The Dodd-Frank Act eliminated the Office of Thrift Supervision (OTS), a massive change for the regulation of institutions operating under the federal savings association charter. All rule-writing and interpretation under the Home Owners’ Loan Act (HOLA) for federal and state-chartered savings associations will now be done at the OCC, with the exception of consumer protection. Supervision for all federal savings associations falls under the OCC, and under the FDIC for all state-chartered savings associations. Both the mutual and stock forms of the federal savings association charter and the powers and authorities of federal and state savings associations under HOLA are continued as before, with the exception of amendments that matched preemptive authority under HOLA to the authority under the National Bank Act.

**WHY IT MATTERS**

There are significant differences in authorities, limitations, interpretation and congressional intent for the charters under HOLA and the National Bank Act. Cultural and operational differences among the agencies will likely result in changes in regulation, such as differences in approaches to interest-rate risk management. Savings associations face the most risk from regulatory changes that may be inconsistent with statutory intent or impose costs without adequate regard to benefits. However, the evolution that is bound to occur may also provide an opportunity to remove unnecessary constraints and to adopt changes that streamline regulation for savings associations.

**GET INVOLVED**

- **Engage the OCC and be proactive.** The OCC is offering outreach programs that inform savings associations about OCC intentions, expectations and procedures. These programs help the OCC better understand the unique characteristics, benefits and obligations of savings associations, which will help the OCC make better decisions.

- **Be prepared to discuss your institution’s business model in detail.** The more the examiners-in-charge, portfolio managers and assistant deputy comptrollers understand your goals and management, the better your relationship with OCC will be.

- **Watch for ABA events and bulletins.** ABA regularly reports on OTS/OCC integration milestones, and sponsors or provides venues for bankers to meet with senior OCC staff. Look for notices in ABA Daily Newsbytes.

- **Keep ABA staff and ABA’s OTS/OCC Integration Task Force informed.** Tell us about any concerns you have, problems you see, or experiences with examination processes. Contact Bob Davis.

- **Volunteer to be nominated to the OCC’s Mutual Savings Association Advisory Committee** if you are a mutual savings association. Contact Bob Davis.
WHAT TO WATCH OUT FOR

Federal Mutuals Included in Transfer
Federal mutual savings associations are among the groups transferring to the OCC and, while there are personnel moving from the OTS to the OCC who are experienced in supervising mutually chartered institutions, federal mutual savings associations are now a smaller component of all of the charters supervised by the OCC than was the case at the OTS. This runs the risk of treating all charters alike, without recognizing the unique characteristics of the mutual charter.

Staff Changes Should be Monitored
Most OTS staff transferred to the OCC, and a sizable contingent of OTS staff transferred to FDIC. Both the OCC and FDIC have committed significant resources to staff integration. However, transfer and utilization of the OTS’s valuable and unique staff talent will be a complex and ongoing process that needs to be monitored.

OCC Integrating Rules for National Banks with Those from OTS
The goal is to produce, when possible, a consistent supervisory approach and a better integrated policy platform for national banks and federal savings associations, while recognizing the differences anchored in statute.

OCC Commitment to Thoughtful Review of More than 1,000 Supervisory Policies of OTS
On December 8, 2011, the OCC outlined the process to evaluate former OTS guidance to address common supervisory issues consistently, and to accommodate regulatory and statutory differences appropriately.

Convergence of Rule Books Raises Questions and Uncertainty
Most OTS rules and regulations were transferred to the OCC en bloc and will remain effective unless or until modified by rulemaking with public notice and comment. Efforts to integrate separate rulebooks based on HOLA and the National Bank Act will raise several questions, such as:

- Does “simplifying” create more complications for banks?
- How homogenous can rulebooks based on different statutes really become?
- Will the OCC support regulatory or statutory changes to relax certain HOLA limitations?
- Will consolidation diminish beneficial charter diversity?
- How much will supervision of interest-rate risk management change for savings associations?
- Will concentration in housing assets be regarded differently from other asset concentrations?

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Nationally chartered banks and thrifts have long been protected by federal law from having to comply with state laws that are inconsistent with federal laws. State-chartered banks are often not subject to state laws if they do not apply to national banks. In 2009, the Obama Administration proposed eliminating federal “preemption” and making national banks and thrifts subject to state consumer laws.

Due to the leadership of ABA, and with the help of key members of Congress, the Dodd-Frank Act essentially preserves preemption for national banks and thrifts—a significant improvement over the Administration’s preemption proposal.

The Office of the Comptroller of the Currency is now the primary force behind viable federal preemption protection. In July 2011, the OCC issued a final rule on preemption that is consistent with the language and intent of Dodd-Frank, stating that the preemption standard for national banks and federal thrifts remains the standard described by the U.S. Supreme Court in the *Barnett Bank* case.

**WHY IT MATTERS**

Federal preemption has always been critically important for all banks that operate across state lines. Today, it is more important than ever, since there is essentially a national financial services marketplace. Without it, a patchwork of inconsistent state laws would drive up the cost of financial products and make consumers’ financial lives more complicated. It is also very important to state-chartered banks and savings associations that, under the laws of many states, do not have to comply with varying state laws that have been preempted for national banks or federal thrifts.

**GET INVOLVED**

- *Join ABA in proactively engaging with regulators and the courts* in support of our view that the OCC’s final rule on preemption closely follows congressional intent in Dodd-Frank. Defending preemption is a priority issue for ABA.

- *Stay alert for legislative, regulatory and legal challenges to federal preemption.*

- *Monitor state legislatures and state attorneys general,* as they may push the envelope in this area.

- *Let ABA know immediately of issues* that arise and keep your state association informed.
WHAT TO WATCH OUT FOR

The Elimination of Preemption for Operating Subsidiaries
Dodd-Frank maintains the legal standards for preemption set by the Supreme Court in *Barnett Bank v. Nelson*. This is generally the same standard that the OCC used prior to passage of Dodd-Frank. The one expressly substantive change made by Dodd-Frank was to eliminate preemption protection for operating subsidiaries of the bank, which previously had enjoyed such protection.

Case-by-Case Decisions on Future Preemption Decisions
Dodd-Frank changed certain procedures regarding how the OCC will make preemption decisions. For example, the OCC may only preempt state law on a case-by-case basis—as opposed to by regulation—and such decisions must be based on a strong administrative record.

The Same Preemption Standards for Federal Savings Associations
Federal savings associations are now subject to the same preemption standards as national banks. Prior to the enactment of Dodd-Frank, federal savings associations arguably enjoyed broader preemption standards than national banks.

State AGs Testing Preemption Standards
State AGs were explicitly given federal authority to enforce “applicable” (e.g., nonpreempted) state law. This is not different from the law applicable prior to Dodd-Frank—if preempted, it is not “applicable.” However, the existence of this provision does act as an invitation to state AGs to test the limits of the preemption doctrine.

Opponents Testing *Barnett* Standard in Court
Opponents of the OCC’s interpretation of the *Barnett Bank* case, including consumer groups and many state AGs, continue to take aim at this reading, arguing that Congress in Dodd-Frank did in fact change the legal standards for preemption. Opponents are likely to test the *Barnett* standard in court.

New Comptroller of the Currency
The views of the OCC are very important to the courts. With a new Comptroller of the Currency expected this year, the industry must watch closely for any change in agency position.

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The Dodd-Frank Act dramatically altered the landscape for savings and loan holding companies (SLHCs). Regulatory and supervisory jurisdiction was transferred to the Federal Reserve. The explicit statutory requirements for SLHC capital and the source of strength obligations are among the most important changes specific to SLHCs.

**WHY IT MATTERS**

Transfer of regulatory supervision to the Fed occurred without transfer of any knowledgeable personnel and without any of the history or background of the day-to-day supervision of the SLHCs, including mutual holding companies (MHCs) and grandfathered unitaries. As a consequence, the Fed is using its existing bank holding company (BHC) format to supervise SLHCs, allowing for variation when the Home Owners Loan Act (HOLA) provides a statutory difference. That means that all of the people who had experience dealing with SLHCs and their variations either went to other agencies or retired. For both bankers and the Fed, it is a brave new world.

**GET INVOLVED**

- **Talk to the Fed about your concerns and your particular situation.** The sooner you know your new regulators and they know you, the better the supervisory dialogue will be.

- **Comment on regulatory proposals.** Key to the development of regulations is learning what works and what does not. Your voice and practical implementation issues are important to share with the Fed.

- **Share your wisdom with ABA.** The ABA OTS-FRB Transition Task Force needs to hear from you so that it may reinforce your issues and concerns. Contact Darlene Thomas for more information at 202-663-5033 or e-mail dthomas@aba.com.
WHAT TO WATCH OUT FOR

**New Reporting Requirements**
In addition to changing from the Thrift Financial Report to the Call Report, the Fed is already issuing new SLHC reporting requirements that begin in 2012. There are a few things that will stay the same, at least in the short term. Some of the prior OTS reporting forms, like the H-(b)11, will continue. Some SLHCs will be exempt from several of the Fed's Y-series reports for a time. However, multiple new systems and structures will have to be developed while implementing reporting changes for subsidiary savings associations.

**Source of Strength Explicit for Holding Companies**
The Fed views the holding company as a source of strength to the underlying depository and cannot fathom why any holding company would waive payment. This means that holding companies will have to find ways to put usually passive monies to use and manage their tax and other issues.

**Dividend Approvals and Waivers**
The Fed was given duplicative authority with the OCC to approve federal savings association dividend payments. In addition to the restrictions now placed on MHC dividend waivers, paying and waiving dividends is much more difficult. For MHCs that had paid dividends prior to December 2009, the Fed proposed an onerous process that makes waiving dividends difficult and painful for the boards of partially public MHCs.

**Flexibility to Customize Capital for SLHC Eliminated**
The OTS used to have the flexibility to customize capital requirements for SLHCs to allow variation for risk, level of activities, and deployment of funds. Now, all SLHCs will be required to meet regulatory capital levels in order to serve as a source of strength to the underlying insured depositories. This may cause stress to some holding company structures if both the depository and the holding company are seeking additional capital.

**Higher Capital Possible Depending on Fed View of Real Estate Concentration**
Depending on the Fed’s view of the mandated real estate concentration of savings associations, there may be a higher capital requirement to match any perceived higher level of risk.

**SLHCs Will Have to Meet BHC Standards for Section 4(k) Activities**
Under the OTS, SLHCs could engage in activities closely related to banking—4(k) activities—without having to meet the well-capitalized and well-managed criteria of financial holding companies. The Fed now requires SLHCs and all of their depository institutions to meet the well-capitalized and well-managed criteria of BHCs even when their activities are closely related to banking. Failure to meet the requirements may trigger enforcement or divestiture actions. It is unclear how SLHCs engaged in 4(k) activities with existing enforcement actions or lower examination ratings will be able to comply within the Fed deadlines.

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The Dodd-Frank Act imposes significant new regulations that affect all banks that use swaps and security-based “swaps.” Dodd-Frank mandates central clearing, exchange trading and transaction reporting for most swaps. New margin requirements will now apply to all uncleared swaps. Even community banks that enter into swaps with customers may have to register as swap dealers that will be subject to comprehensive Commodity Futures Trading Commission and Securities and Exchange Commission regulation. Regulators have proposed dozens of regulations to implement the Dodd-Frank swaps mandates. Many of those rules may be finalized and could also become effective in 2012.

**WHY IT MATTERS**

Banks that use swaps will be affected by the new regulatory framework. Some issues to consider:

- Mandatory clearing and exchange trading are incompatible with customization.
- Dozens of anticipated regulations will add significant compliance costs and operational burdens.
- Pace and volume of rulemaking has overwhelmed most banks.
- Some banks will be subject to oversight by the CFTC, the SEC, the National Futures Association and FINRA.
- Margin requirements for uncleared swaps may tie up significant liquidity.
- If only large banks can afford to continue using swaps, community banks may not only lose an important tool to hedge risk, but may also lose loan business.

**GET INVOLVED**

- **Participate in the ABA Swaps Working Group.** ABA has written or joined other trade associations in filing more than 15 comment letters, submitted written statements for House and Senate hearings and debates on derivatives reform, and had numerous discussions and meetings with regulators and House and Senate staff. These and other efforts are ongoing. To join in these efforts via the Swaps Working Group, contact Diana Preston.

- **Tell us your concerns.** We need to understand how your bank uses swaps and how the new rules will affect your business. We need your help to identify specific issues so we can advocate on your behalf.

- **Call or write your senator and representative.** Let them know specifically how the new regulatory framework will affect your bank. Will swaps still be a cost-effective way for your bank and bank customers to hedge risk? Will the new regulations affect your ability to provide long-term or fixed-rate financing?

- **Submit comment letters on the proposed rules.** Even if the comment deadline has passed, it is not too late. The regulators are still accepting comments on proposed swaps rules that have not been finalized. Contact Diana Preston for more information.
WHAT TO WATCH OUT FOR

Rulemaking Will Impact All Swaps Transactions
New rules coming out this year will affect all banks that use swaps. Depending on the types of transactions, even community banks may be required to comply with new clearing, margin and swap dealer regulations.

“Small Bank” End-User Exemption from Mandatory Clearing
If your bank uses swaps, then the bank may have to clear all swaps even if they are only being used to manage balance sheet risk. The CFTC and the SEC are required to consider an exception for “small banks” that use swaps to hedge or mitigate risk, but they are not required to grant one.

New Margin Requirements Regardless of Bank Size
Even if your bank is not subject to mandatory swaps clearing requirements, any uncleared bank, customer and interaffiliate swaps may be subject to “initial” and “variation” margin requirements that are higher than clearinghouse collateral requirements. Eligible collateral may also be limited to cash, U.S. Treasuries and senior debt obligations of government-sponsored enterprises.

Swap Dealer Definition May Capture Community Banks
If your bank enters into swaps with customers, then the bank may be required to register as a swap dealer and be subject to comprehensive regulation by the CFTC and/or the SEC unless it qualifies for an exemption. Swap dealers also will have to “push” some swaps—including commodity swaps—out of the bank into a nonbank affiliate. There is an exemption from the swap dealer definition for insured depository institutions that enter into swaps in connection with originating loans, but the proposed exemption may be interpreted narrowly and limited to swaps entered into simultaneously with loans.

Stay Tuned for Legislation and Hearings
There are now nearly a dozen bills that are pending that would, among other things, provide a clearing exemption for banks that use swaps to hedge or mitigate risk, clarify the swap dealer definition to ensure that it will not be as narrow as in the proposed CFTC and SEC rules, and repeal the push-out requirement. The House Financial Services Committee approved two bills with strong bipartisan support that would provide exemptions from the margin requirements for interaffiliate swaps and for nonbanks that use swaps to hedge or mitigate risk. The House Agriculture Committee is also considering several important bills. Regardless of whether any of the legislation is enacted, hearings and pending legislation are likely to influence the swaps rulemaking.

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Section 619 of the Dodd-Frank Act, the “Volcker Rule,” broadly prohibits all insured depository banks and their affiliates from engaging in “proprietary trading” and from investing in “covered funds,” namely, hedge funds and private equity funds. The rule proposed by the Fed, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Securities and Exchange Commission attempts to curb excessively risky bank trading and investment activities. Instead the rule broadly prohibits a host of legitimate principal trading and investment activity.

**WHY IT MATTERS**

The Volcker Rule, as currently proposed, may affect “core” banking activities, including asset/liability management. The proposed rule could also limit certain hedging activity (e.g., hedging related to mortgages or other lending activities), as well as ownership in certain funds (e.g., CRA investments, pension plans, etc.). All banks must evaluate existing compliance programs to be sure any principal trading activities and ownership in or advice to “hedge funds” and similar funds are in line with the final rule when it becomes available.

**GET INVOLVED**

- **Join with ABA** in actively engaging the Fed, the OCC, the FDIC, the SEC, the CFTC and Congress to advocate for a sensible and targeted implementation of the Volcker Rule.

- **Participate in one or more of the three ABA Working Groups.** ABA has working groups on proprietary trading, hedge fund/private equity funds and midsize banks. The Midsize Bank Working Group consists of both community banks and regional banks. Contact Tim Keehan for more information.

- **File a comment letter on the proposed rule or participate in the ABA comment letter.** File a comment letter to the agencies describing the proposed rule’s effect on your institution.

- **Support congressional efforts to ensure accountable and appropriate rulemaking.** Write to your congressman and senators supporting their efforts to ensure that the Volcker Rule is properly and narrowly tailored to address only excessively risky trading and investment activities.

- **Tell us about any concerns that arise as the Volcker Rule is fleshed out.** Make ABA staff aware of any operational or compliance issues that surface as the federal regulatory agencies craft, finalize and enforce the Volcker Rule’s provisions. The volume and complexity of the proposed rules virtually assure that issues will continue to arise throughout the entire rulemaking and implementation process.
WHAT TO WATCH OUT FOR

Release of Lengthy and Complex Final Rules
The regulatory agencies have proposed a lengthy and complex rule, which must be finalized by July 21, 2012. Among other things, this rule may require banks to divest from certain Community Reinvestment Act-eligible investments, as well as require extensive compliance regimes to monitor the bank's asset liability management activities. The CFTC has issued its own version of the proposed rules. For purposes of the Volcker Rule, the SEC and CFTC each may have jurisdiction over a part of your bank if it is engaged in certain swaps or security-based swaps activity.

Banks May Be Required to Divest CRA Assets
The agencies’ new rules may require banks to divest certain Community Reinvestment Act-eligible investments.

New Compliance Requirements
New rules will almost certainly require banks to implement extensive compliance regimes to monitor liquidity management activities.

Possible Extension of Effective Date
The Volcker Rule takes effect on July 21, 2012, whether or not the proposed implementing rule is finalized. Compliance programs must be in place by the July 21 date. The regulatory agencies may have authority to extend the compliance date in order to give banks time to bring their activities into conformance with the Volcker Rule's requirements.

Continued Congressional Oversight
Members of Congress have been following the progress of the Volcker Rule implementation, and plan on holding hearings to examine more closely how the rule will affect the financial system and banks of all sizes. Certain representatives have also filed letters with the regulatory agencies urging more time for comment, as well as commenting on the direction of the rule.

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ABA’s Dodd-Frank Resources

As the banking industry’s champion, ABA provides information, expertise and resources to help banks meet the challenges of the post-Dodd-Frank environment.

LEVERAGE STAFF EXPERTISE

ABA Staff Banking Experts—we respond directly to your specific questions and concerns.

Call 1-800-BANKERS or visit aba.com/Experts

ABA’s Compliance Professionals—get assistance from the ABA Compliance Hotline on a broad range of issues, from general compliance to specific regulations and exam disputes.

Call 1-800-551-2572

TAP IN TO INFORMATION AND RESOURCES

The ABA Dodd-Frank Tracker—provides up-to-the-minute updates on Dodd-Frank implementation.

Visit RegReformTracker.aba.com

ABA Daily Newsbytes—a summary of the latest developments from Capitol Hill, the White House and the bank regulatory agencies delivered first each weekday morning to your e-mail inbox. ABA also offers more than 30 other free issue-specific e-mail bulletins.

Visit aba.com and click on E-mail Bulletins under Member Resources

ABA Media Guide—talking points on Dodd-Frank and other timely banking issues to help ABA members respond to media inquiries and work with reporters and editors on a regular basis.

Visit aba.com and click on Communication Tools under Member Resources

ABAWorks & Toolboxes—comprehensive resource guides for ABA members covering key topics of compliance, operations and security. Topics include RESPA, Reg Z and Fair Lending (upcoming).

Visit aba.com and click on ABAWorks/Toolboxes under Member Resources

ENGAGE IN GRASSROOTS AND ADVOCACY

Direct Contact Bankers—program for bank presidents, chairs and CEOs who want to build and maintain a relationship with their Member of Congress.

Bank Advocates—program for bank directors and bank employees who want to be more involved in ABA’s grassroots efforts.

Visit aba.com/grassroots

Web site page accessible only to ABA members
CONNECT THROUGH PEER NETWORKING

Professional Networking Sites—more than 10,000 ABA members share information, resources and ideas on important issues on ABA's professional networking sites, including the ABA Member Network and the ABA Compliance Network.

- Visit aba.com and click on Professional Networking Sites under Member Resources

ABA Conferences—many ABA conferences offer special sessions dedicated to Dodd-Frank issues and provide opportunities for bankers to exchange experiences and learn from peers.

- Visit aba.com/events/conferences for a complete calendar

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ABA provides significant training resources delivered online, via conference call and in person.

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- Visit aba.com/frontline

Telephone Briefings—an efficient and cost-effective way to receive information and insights from ABA and industry experts.

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ABA National and Intermediate Compliance Schools and the Graduate School of Compliance Risk Management—special Dodd-Frank-related sessions provide tools to cope with the latest developments affecting banks and the industry.

- Visit aba.com/events/schools

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ABA members are offered endorsed products and banking solutions through its subsidiaries, the Corporation for American Banking and Business Solutions. Relationships with leading industry suppliers and institutions provide ABA members with access to expert resources to assist them with Dodd-Frank and other key banking issues.

- Visit aba.com and click on Endorsed Products or Business Solutions under Products
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