Welcome

Financial Reform Legislation Updates for Financial Institutions

December 7, 2010

Omaha, Nebraska

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Deposits and Payment Systems

By: J. Daniel Stinnett

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Deposit Insurance Changes

- $250K deposit insurance limit is effective
- For a period of two years beginning December 31, 2010 non-interest bearing transaction accounts will have unlimited deposit insurance

Deposit Insurance Changes

- Effective July 21, 2011 banks may pay interest on business checking accounts

- Assessment Base is changed from deposits to assets. Regulations addressing implementation issues are expected by year end with an effective date in early 2011

Durbin Amendment
(Effective July 21, 2011)

- Debit card interchange fees to be limited to "reasonable" and "proportional" to the transactions
  - Rules to be published by April 21, 2011
  - Exemption for banks under $10 billion in assets

Durbin Amendment
(Effective July 21, 2011)

- Federal Reserve to adopt rules to ban network "exclusivity"
  - Bans any requirement that debit transactions be processed through any particular network
  - No exemption for banks under $10 billion in assets

Not Your Father's Bureau: The Consumer Financial Protection Bureau

By: Jeff Heuer

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Rosetta Stone

- Unfair, unconscionable, deceptive or abusive
- Ability to pay
- Reasonable opportunity to…
- Clear, meaningful, simple, segregated, enhanced and/or plain
- Additional disclosure if…
- Steering

Rosetta Stone

- Based on consumer testing
- Inform, monitor, counsel and vigilant to…
- Promptly honor…
- Accurate and balanced
- Adopt policies to insure…
- Excessive
- Fair

CFPB Purposes

- Protection from UDAAP’s
- Assure consumer access to financial products and services
- “Fair, transparent and competitive” financial products and services
- “Timely and understandable information” to make good decisions
- Consistent enforcement

Structure

- Creation
- Six primary functions
  - Education
  - Complaint response
  - Market research
  - Identify risks
  - Rulemaking and guidance
  - Supervision and enforcement
- Six "Special Function Units"

Structure

- Independent bureau within FRB
- Director
- “Transfer Date”
- Remaining duties
- Treasure Secretary’s role
- *$$500-650mm budget*
- @1,500 employees

Authority

- "Covered Person" – any person engaged in offering or providing "consumer financial products or services"
  - Depository – Banks, Thrifts and CU's
  - Non-Depository – TBD, but ….

Authority

- "Consumer Financial Products or Services" listed in §1002(15) include:
  - Extending/servicing loans and leases
  - RE settlement services
  - Deposit-taking activities
  - Stored value
  - Check cashing and collection
  - Payment or financial data products and services
  - Data collectors

Exemptions From CFPA

- SEC, state securities, CFTC, FCA and insurance regulated persons
- Motor vehicle dealers not holding paper, but…
- RE brokers
- Accountants/Attorneys
- “Main Street Merchants”, but …
- As Bureau decides

Existing Authority

- Consumer protection function over existing statutes/regulations:
  - TILA, TISA, EFTA, HOEPA, ECOA, FCRA, FDCPA, GLB, HMDA, RESPA, S.A.F.E. Act, and Consumer Leasing Act (18 in all!)
  - Consumer oriented, but:
    - ECOA
    - Small business loan data collection

Rulemaking

- Comprehensive authority over covered persons for all federal consumer financial protection laws
  - Rulemaking
  - Regulations
  - Guidance

Examination and Enforcement

- $10B+ asset depository institutions
  - Exclusive examination authority over consumer financial protection laws
  - Primary enforcement authority over consumer financial protection laws – other regulators retain “secondary authority”

Examination and Enforcement

- Less Than $10B asset depository institutions
  - Secondary examination authority
  - No enforcement authority
- Non-depository institutions
  - TBD
  - FTC's role?

Enforcement Powers

- Investigations
- Administrative subpoenas
- Hearings
- Adjudication proceedings
- C & D
- Civil litigation – broad remedies

Limitations

- *When rulemaking, must*
  - Consult with "prudential regulators" prior to rulemaking
  - Respond to their objections during rulemaking process
  - Consider potential benefits and costs to covered persons and consumers
- Secretary of Treasury may stay 90 days

Limitations

- *Oversight Council veto if risk to*:
  - Safety and soundness of U.S. banking system, or
  - Stability of U.S. financial system
- Do Not Enter
  - Interest rate caps and usury
  - Interest rate exportation
  - Interchange fees

Miscellaneous

- Pre-dispute arbitration
  - Must conduct study on pre-dispute arbitration
  - May choose to ban or condition use
- Disclosures, Models and Forms
  - Broad authority
  - Likely to synthesize TILA and RESPA mortgage loan forms and disclosures

State Authority

- "Preservation of State Law" – anti-preemption sentiment combined with states' rights enthusiasm
- Propose rulemaking upon state majority request
- AG's may enforce Bureau rules against covered persons except as "class-action-like" lawsuit to benefit citizens of a state
- State bank regulators can only enforce Bureau rules against state-chartered banks

Preemption

- State consumer financial laws preempted only if:
  - Effect is to discriminate against national entities, or
  - “Prevent or significantly interfere” with national entities’ exercise of powers (*Barnett*), or
  - Otherwise preempted (except by NBA)

Preemption

- No preemption for nonbank national subsidiaries, affiliates and agents (*Watters* overruled)
- No "field preemption" (12 CR §§557 and 4007)(*Barnett*)
- Case-by-case agency determination (*Barnett*)

Preemption

- Less deference upon judicial review
- *Cuomo* standard codified
  - *"Visitorial Powers" do not preempt state's enforcement of generally applicable state or federal laws*

Break

Regulatory Reform: Capital, 23A and B, Mark-to-Market, Securitization, Commercial Lending, And All That Jazz

Moderator: Joyce Dixon
Panel: Dale Dixon
Adam Kirshenbaum
Aaron Johnson
Jeff Makovicka

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Over-Arching Principles

- Demise of Glass Steagall brought depository institutions back into riskier businesses which need greater regulatory scrutiny
  - Derivatives, securities lending/borrowing, repurchase transactions
  - Proprietary trading
  - Relationships with hedge and private equity funds

Over-Arching Principles

- Too little capital and standards which do not move quickly enough to adjust for additional risks
- Interconnectedness of financial companies – bank and non-bank

Volcker Rule

Three-Pronged Attack

- Proprietary trading
- Ownership interest in hedge or private equity fund
- Sponsoring hedge or private equity fund

Volcker Rule

- Proprietary trading
  - Exceptions:
    - Trust Services
    - Short-term underwriting for customers
    - Government securities
    - SBICs

Volcker Rule

- Ownership interest in hedge and private equity funds:
  - Exceptions:
    - Seed capital: Reduce to 3% ownership interest in 1 year, cannot sell to bank’s directors or employees
    - De minimis investment (3% of bank’s capital and surplus)

Volcker Rule

- Sponsoring hedge and private equity funds:
  - General partner, managing partner or trustee
  - Controlling selection of officers, trustees, etc.
  - Exceptions
    - Not same or similar name
    - Fund only for trust or investment advisory customers
    - Prohibits bank directors or employees from ownership interest

Can still advise hedge and private equity funds

Sections 23A and 23B of the Federal Reserve Act (Regulation W)

By: Aaron Johnson

23A

- Imposes collateral reserve requirements on certain transactions with an affiliate that vary based on the credit exposure undertaken by the bank and limits the volume of affiliate transactions to a percentage of the bank's capital stock and surplus

"Covered transactions" under 23A currently include:

- Loan or extension of credit to an affiliate
- Purchase of or an investment in securities issued by an affiliate
- Asset purchases, including repurchase agreements
- Acceptance of securities issued by the affiliate as collateral or security for a loan extended to any person or company issuance of a guarantee or letter of credit for or on behalf of an affilate

23B

- Requires that certain "covered transactions" and related transactions with an affiliate (including any sale of assets or furnishing of services) be made on the basis of market rates and market terms that would otherwise apply if the transaction was at arms-length with a non-affiliated party.

Frequently Used Current Exceptions

- Operating subsidiaries are not affiliates
- Finance company subsidiaries are affiliates but not subject to 10% limitation with a single affiliate
- Sister bank exception
- Purchase of loans which were pre-approved by the bank

Impact of Dodd-Frank

- Expansion of "Covered Transactions"
    - Derivative transactions
    - Acceptance of debt obligations
    - Expanded categories of repurchase agreements
    - “Covered transactions" now generally include any transaction in which a bank would experience credit exposure relating to a transaction by or with its affiliate
  - Revisions to Collateral Requirement
    - Collateral required at all times
    - Ineligible collateral
      - Affiliate debt obligations as collateral for loan or derivatives transaction
      - Prohibition on low-quality assets

- Conditions for Deeming an Investment Fund a Bank Affiliate
  - Broadens coverage
  - Covered if bank or bank affiliate advises the fund
- Modification of Exemptive Authority
- Elimination of Special Rule for Financial Subsidiaries
  - Transactions with financial subsidiary are subject to the 10% individual affiliate quantitative limit

Asset Purchases from Insiders

- Extends valuation restrictions similar to those in Section 23B on transactions between any insured institution and one of its executive officers, directors or principal shareholders
- If transaction constitutes more than 10% of the institution's capital stock and surplus, a majority of the uninterested directors must pre-approve the transaction

- Volcker Rule
  - Total prohibition against covered transactions with related hedge fund or private equity fund
- New Rules to be Adopted for Other "Systemically Important Non-Banks"

Effective Dates

– General 23A changes:

  24-30 months after July 2010

- Volcker prohibition: earlier of July 2012 or 1 year after final rules

– Systemically important non-bank rules:

  3-5 years after July 2010

New Capital Requirements

By: Jeff Makovicka

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Capital Requirements

- Sec. 171 – "Collins Amendment"
  - The appropriate Federal banking agencies must establish minimum leverage and risk-based capital requirements to apply to insured depository institutions, depository institution holding companies and systemically important nonbank financial companies. These minimums may be increased by the applicable banking agencies to reflect higher risk activities or assets.
  - Requires holding companies and nonbank financial companies supervised by Federal Reserve to comply with leverage and risk-based capital requirements imposed on depository institutions.
  - Leverage capital requirements may present the greatest capital challenge.

Minimum Capital and Leverage Ratios

- The Collins Amendment establishes a floor for capital that cannot be lower than the standards in effect as of the date of enactment
- Within 18 months after the enactment of the Dodd-Frank Act the banking regulators must issue rules to establish minimum risk-based capital and leverage standards applicable to insured depository institutions, insured depository institution holding companies, and systemically important nonbank financial companies

Minimum Capital and Leverage Ratios

- Must include off-balance sheet activities in calculating new capital requirements
- Must address risks relating to derivatives, securitized products, financial guarantees, securities borrowing and lending, repos, and concentrations in assets where values are model-driven
- New capital requirements must be countercyclical

Basel III

- The Collins Amendment does not expressly permit the U.S. banking supervisors to amend capital adequacy guidelines in accordance with the standards that will be applied internationally when Basel III is implemented
  - As a result, the Collins Amendment will create a statutory floor and U.S. banking regulators would be able to implement Basel III only to the extent it is consistent with the Collins Amendment floor
  - It appears that regulators would generally be able to impose more stringent Basel III capital rules on insured depository institutions and bank holding companies than those that have applied historically to banks but would not be able to apply less stringent rules, with the possible exception of giving effect to any countercyclical requirements contemplated by Basel III and the Dodd-Frank Act

No Tier 1 Treatment for Trust Preferred Securities

- Effective Dates/Exceptions
  - Securities issued on or after May 19, 2010 – effective as of July 21, 2010
  - Securities issued before May 19, 2010
    - Large Institutions (>$15 billion as of December 31, 2009)
      - Three-year incremental phase-in starting January 1, 2013
  - Other institutions ($15 billion or less)
    - Grandfathered: Permanent Tier 1 Treatment
- Exclusions
  - Federal Home Loan Banks
  - TARP CPP Preferred Stock
  - Small bank holding companies

Small Bank Holding Companies

- Policy statement found at 12 CFR Part 225, App. C
- Consolidated assets of less than $500 million
- Not engaged in significant nonbanking activities
- Does not conduct significant off-balance sheet activities (including securitization and asset management or administration)
- Does not have a “material amount” of securities registered with SEC
- Not excluded by Federal Reserve Board for supervisory purposes

Phase-In Schedule

- Collins Amendment
  - Timing:
    - Risk based capital: 18 months
    - Leverage ratio: 18 months
    - Trust preferred exclusion: Phase-in over 2013 - 2016
- BASEL III
  - Timing:
    - Phase-in over 2013-2019
- Countercyclical Capital Requirements
  - Timing:
    - To be determined by bank regulators
- New Higher Standards for Systemically Important Banks
  - Timing:
    - Generally, 18 months

Other Capital Changes

- Section 171(b)(6) – Study small institutions' access to capital
- Section 171(b)(7) – Risks related to institutions' activities to affect required capital ratios
- Section 174(a) – Study regarding hybrid capital instruments
- Section 616(d) – Source of strength doctrine codified
- Section 165 – Enhanced Supervision and Prudential Standards
  - Annual stress tests
  - "Living Will" requirements
  - Concentration limits
  - Leverage Limitations
  - Risk Committees
  - Short term debt limits

Securitization

By: Dale Dixon

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Risk Retention

- In the Dodd-Frank Act, Congress took the view that abuses in the securitization market contributed to the financial crisis
- The securitization process is designed to reduce risk for investors by legally isolating the collateral pool from the originator’s bankruptcy estate

Risk Retention

- To achieve legal isolation, among other things, the structure must transfer most of the risks of ownership of the collateral (such as credit risk and interest rate risk) from the originator to the investor

Risk Retention

- Congress believed that in certain sections of the securitization market (primarily residential mortgage-backed securities), lenders had originated loans solely with a view toward selling those loans directly or indirectly into a securitization. Congress believed that in many cases, the originator did not retain any credit risk with respect to the underlying loans, and as a result, origination standards deteriorated and investors suffered losses.
  - This was not an issue for all asset classes. For example, credit card originators have historically maintained a pro rata interest in securitized credit card pools.

Risk Retention

- The Dodd-Frank Act addresses this by requiring a securitizer to maintain no less than 5% of the credit risk in assets it sells into a securitization
  - The securitizer cannot hedge this credit risk

Risk Retention

- The risk retention requirement does not apply to “qualified residential mortgages” – i.e., mortgages that, among other things, are fully amoritzing, do not have unconventional attributes (such as interest-only payments, negative amortization or balloon payments), that meet debt-to-income or other affordability standards, and do not include excessive points and fees

Risk Retention

- The Dodd-Frank Act also directs the Federal banking regulators and the SEC to adopt regulations implementing the risk retention provisions of the Act

Risk Retention

- 12 CFR §360.6 (the "FDIC Rule") is the safe-harbor rule established by the FDIC with respect to securitizations. Under the FDIC Rule, the FDIC in its capacity as conservator or receiver for a failed insured depository institution will not reclaim assets transferred by the institution in a securitization that meets the requirement of the FDIC Rule.
  - Compliance with the FDIC Rule is one way in which insured depository institutions achieve "legal isolation" in a securitization

Risk Retention

- Under the new FDIC Rule:
  - Many existing master trusts are "grandfathered" and not subject to the new requirements.
  - New requirements for transactions that are not "grandfathered," such as:
    - Sponsor must retain at least a 5% economic interest on the transaction, either through a "vertical slice" of all tranches or 5% of the underlying assets, subject to change after the new Dodd-Frank risk retention rules come into effect.
    - Regulation AB disclosure required in all transactions (both prior to sale and thereafter), whether or not registered.
    - Must use "standardized documentation" for the applicable asset class.
    - Additional substantive requirements apply if the underlying assets include residential mortgages.

Commercial Lending Issues:

Mark-to-Market Accounting
Lease Accounting
Capital Gross-Up Provisions

By: Adam Kirshenbaum
Aaron Johnson
Jeff Makovicka

Commercial Lending Issues Mark to Market Accounting

- FASB Proposed accounting standards update
  - Would require presentation of both amortized cost and fair value on statement of financial position for most financial instruments held for collection or payment of cash flows
  - Would include both amortized cost and fair value information for financial instruments in determining net income and comprehensive income
  - Would require financial instruments held for sale or settlement (primarily derivatives) be recognized and measured at fair value
  - Would require core deposit values to be based primarily on present value

Commercial Lending Issues
Mark to Market Accounting

- Practical implications for Commercial Lending Market
  - Valuation of unfunded loan commitments and loans to be held to maturity in the same manner as loans to be sold
  - Movement away from products with greater volatility in market price (30 year fixed rate mortgages, etc.)

Commercial Lending Issues Mark to Market Accounting

- Phase in
  - Nonpublic entities with less than $1 billion in assets would be subject to four-year deferral

Commercial Lending Issues Lease Accounting

- GAAP Proposed accounting changes for leases
  - Current accounting for capital leases vs. operating leases
  - Proposed Changes: Operating leases would become on-balance sheet items with assets and liabilities recorded based on the discounted present value of required lease payments. Rent expense would be replaced by amortization (straight line) and interest (front-end loaded) expense. Contingent items such as lease renewal terms would be re-assessed on a continuing basis to reflect the "more likely than not" scenario. This continuing re-assessment would lead to recognition of items during the lease term and not just when they actually occur.

Commercial Lending Issues Lease Accounting

- Impact on lenders
  - Weaken the market for leasing lender
  - Financial covenants for existing corporate borrowers with capital leases will likely need amendment to avoid financial ratio defaults (e.g., return on capital, debt-to-equity, permitted indebtedness or liens, etc.)
- Timing and guesstimates on passage

Commercial Lending Issues
Lease Accounting

- Recommended language options to accommodate uncertainty of these changes
  - Specifically address lease accounting and agree to revise financial covenants
  - Agree that compliance with current financial covenants will continue to be tested based on GAAP lease accounting at time of execution of credit agreement
  - Amend general terms regarding change in accounting rules

Commercial Lending Issues Increased Capital Costs

- Gross-up provisions for change in lender's capital costs attributable to applicable loan facility
  - Typical provisions
    - Changes in laws, interpretations or enforcement which increase cost to Lender(s)
    - After date of original loan facility (typically not updated at time of amendment or renewal of facility)
    - Recapture period may be unlimited or based on costs within prior 6/12 months
    - Lender(s) get to calculate loss; components of loss may or may not be specified
    - Frequently used in syndicated or club credits or multi-year term loans

Commercial Lending Issues
Increased Capital Costs

- Effect of Dodd-Frank
  - Capital charges are going up; gross up clauses are likely to be triggered
  - Borrower concerns with loan amendments, renewals
  - Phased in capital changes make negotiation of gross up clauses more difficult
- Recommended provisions
  - Update to reflect changes in capital levels after adoption date of Dodd Frank
  - Provide for increases which occur as a result of regulation or interpretation after such adoption date
  - Specify components for which lender may be reimbursed
  - Consider an automatic moving of measurement date for amendments or renewals of credit facility
  - Consider including this provision in more loan facilities to cover this substantial pricing risk

SIMPLEXIFY THE COMPLEXIMACATED: TITLE XIV, REGULATION Z AND RISK RETENTION

By:

Jeff Heuer

J. Daniel Stinnett

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Title XIV Overview

- Concerns
  - Lending practices without adequate assurance of repayment - protects holders
  - Lending practices placing borrowers in loans they did not understand or could not repay – protects consumers

Title XIV Overview

- Solutions
  - Originator compensation and duties
  - Lender incentives to offer products in consumers' best interest
  - Consumer protection by way of enlarged claims and defenses
  - Additional disclosures
  - Appraisal reform
  - Consumer education

Mortgage Originators

- "Mortgage Originator" – person who
  - takes a residential loan application
  - assists in obtaining or applying for a mortgage
  - prepares loan packages
  - collects information/negotiates on behalf of consumer for a residential mortgage loan for compensation
- SAFE Act

Mortgage Originators

- UDAAP's
  - Steering a consumer to a product without a reasonable ability to repay
  - Has "predatory effects"; excessive fees, abusive terms, equity strip
  - Not offered a "Qualified Mortgage" if consumer would qualify
  - Involves abusive practices that promote credit disparities

FRB Response - REG. Z September 24, 2010

- Final rule effective 4/1/11 on compensation and steering
  - All persons who originate closed-end mortgage loans
  - Prohibits payments based on interest rate or terms (except as a fixed % of loan amount)
  - Prohibits payments from lender *and* consumer
  - Prohibits steering to less favorable terms

Ability to Repay

- Good faith determination, based on verified and documented information, that consumer has reasonable ability to repay loan, taxes, insurance, assessments and other consensual liens on property

“Qualified Mortgages”

- “Qualified Mortgages” have
  - Regular periodic payments
  - No principal increase
  - No balloon, except…
  - Total point and fees may not exceed 3%
  - Diminishing pre-payment penalty phased out after 3 years
  - Escrow account
  - 30 years or less

“Safe Harbor”

- If a loan is a Qualified Mortgage, there is a rebuttable presumption that consumer has the “ability to repay”
- Creates a “Safe Harbor” to foreclosure and payment defense

HCML

- Modification of HOEPA trigger
- "High-Cost Mortgage Loans" are
  - 1st mortgage P* + 6.5%
  - Junior mortgage or less than $20,000 P + 8.5%
  - Points and fees 5%+ if over $20,000; $20,000 or less than lesser of 8% or $1,000
  - Prepayment fees after 36 months or such fees exceed 2% of prepayment

HCML

- Limited balloon
- Limited late payment fees
- Limited acceleration rights
- No modification, renewal, extension amendment or payoff fees
- No point/fee financing
- Pre-loan counseling

Disclosures

- Title XIV requires lenders to make a series of new disclosures concerning variable rate calculation, escrow, negative amortization, fees, circumstances when counseling is required, “anti-deficiency” statement, and required monthly statement information

FRB Response - REG. Z
September 24, 2010

- "HPML" and "Qualified Mortgages" (re)defined
- Enhanced consumer protections and disclosures for home mortgages
- 29 new model forms/disclosures + "Key Questions" disclosure; many related to Title XIV

FRB Response - REG. Z
September 24, 2010

- Disclosures/Formatting
  - Table form of interest rate and periodic payments
  - Payment schedule should include all components of "finance charge"
  - Mortgage insurance
  - Additional ARM disclosure

FRB Response - REG. Z September 24, 2010

- Disclosures
  - Additional “interest only” disclosure
  - Additional “negative amortization” disclosure
  - Additional “escrow” disclosure
  - Additional “balloon payment” disclosure
  - “No Guarantee-to Refinance” disclosure

Consequences

- Enhanced TILA penalties and SOL (2x and 3 years)
- Foreclosure defense for ability to pay and steering violations + recoupment/setoff (No SOL)
- No mandatory arbitration/ADR or waiver of statutory causes of action
- AG expanded TILA authority
- PTAF extended to 12/31/14

Risk Retention

- Asset-backed securitization improvements to protect investors
- Attempt to insure prudent origination practices in underwriting and risk management by requiring
  - Securitizer/originator 5(ish)% credit risk retention – "SKIN IN THE GAME"
  - Additional disclosures for investors to assess credit quality

Risk Retention

- SEC, FRB, FDIC and OCC must develop
  - "Residential ABS" risk retention regulations within 270 days of enactment, effective 1 year after final rule publication (in conjunction with HUD and FHFA)
  - "General ABS" risk retention regulations within 270 days of enactment, effective 2 years after final rule publication

Risk Retention

- Title IX establishes only very general guidelines and leaves regulators significant discretion
- Exempts "Qualified Residential Mortgages" from risk retention
- FRB initial report on potential impact of risk retention released on 10/19/10

Reverse Mortgages REG. Z September 24, 2010

- Reverse Mortgages
  - Simple, plain two-page disclosure with application
  - Customer counseling
  - Transaction specific three-day follow-up disclosure – tabular form
  - Three-day pre-closing disclosure
  - “Accurate and balanced” advertising
  - No product tying or counselor steering

Rescission REG. Z September 24, 2010

- Rescission Rights
  - Three days to rescind
  - Up to three years if bad notice/disclosure
  - Simplify and improve notice
  - Revise disclosures that can trigger rescission based on "consumer testing"
  - Clarify lender obligations when rescission is asserted

REG. Z - September 24, 2010

- Miscellaneous Provisions
  - Disclosure upon modification
  - Closed-end review time
  - “Holder” information from servicer
  - HELOC advertising conforms to 2008 closed-end mortgage rules

Mortgage Transfer REG. Z September 24, 2010

- Mortgage Transfer Disclosure
  - Interim Rule 11/20/09
  - Mandatory Compliance 1/1/11
- Mandatory Disclosure of Transfer to all Obligors within 30 days
  - Identity, address and phone of transferee
  - Contact person
  - Date transferred

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

SAFE Act Purpose and Policies:

- Purpose: The Act is designed to enhance consumer protection and reduce fraud in the mortgage loan industry by registering mortgage loan originators and maintaining information about them in a Nationwide Mortgage Licensing System and Registry
  - The Registry is administered by the Conference of State Bank Examiners and the American Association of Residential Mortgage Regulators
  - Covered financial institutions must establish policies and procedures to ensure compliance with Registry requirements for reporting and registration

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

- Covered Employees
  - A mortgage loan originator is a person who takes a residential loan application and offers or negotiates the term of the application for compensation or gain
- Residential Mortgage Loans
  - Any loan primarily intended for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

Definitions and Registration Requirements

- Registration Requirements
  - Mortgage loan originators must obtain a unique identifier, register with the Registry, and maintain that registration
  - The unique identifier permanently identifies each loan originator and facilitates information tracking related to their employment history or disciplinary enforcement

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

- Required Employee & Institution Information
  - Employee Information: Covered institutions must require employees to submit to the Registry: (1) identifying information, (2) financial services-related employment history, (3) information about convictions for crimes of dishonesty, (4) information and final orders concerning civil judicial actions and related settlements or actions by state or federal agency against employee based on fraudulent, manipulative, or deceptive conduct, and (5) copies of the employee’s fingerprints

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

– Institution Information: Institutions employing mortgage loan originators are required to submit to the Registry: (1) institutional identifying information, (2) a tax identification number (EIN), (3) an RSSD number issued by the Fed, (4) identification of the primary federal regulator, (5) the name and contact information for the primary contact person, (6) the name and contact information for persons authorized to submit documentation with the Registry, and (7) the RSSD of a parent institution if applicable

Secure and Fair Enforcement for Mortgage Licensing Act (2008) SAFE Act

- Required Policies and Procedures: Institutions that employ one or more mortgage loan originators must adopt written policies and procedures designed to assure compliance

- Best Practices:
  - Establish a process to identify mortgage loan originators
  - Require that mortgage loan originators receive training addressing various aspects of SAFE Act compliance
  - Comply with procedures to confirm the adequacy and accuracy of employee registrations

Best Practices:

- Establish tracking systems to monitor compliance with registrations and renewals
- Provide for independent compliance testing on at least an annual basis
- Provide for appropriate corrective action for employees who fail to comply with registration requirements
- Review Section 19 of the FDIA on the hiring and retention of employees with criminal records
- Review employment policies, applications, and any employee questionnaires
- Ensure that all third parties with which the institution has an arrangement related to mortgage loan originators comply with all requirements under the Act

Corporate Governance and Risk Management

By: J. Daniel Stinnett

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Compensation Provisions

- "Covered Financial Institutions" will be required to disclose incentive - based compensation arrangements to the appropriate federal regulator

Compensation Provisions

- The definition of "Covered Financial Institution" includes any:
  - Depository institutions
  - Holding companies
  - Broker-dealers
  - Credit unions
  - Investment advisers
  - Fannie Mae and Freddie Mac
  - Any other financial institution that regulators want to cover
  - With assets greater than $1 billion regardless of whether publicly traded or not

Compensation Provisions

- Prohibition against any arrangement with any officer, employee, director, principal shareholder that encourages risk by reason of excessive compensation or that could lead to a material loss

Compensation Provisions

- Compensation can be either fees or benefits determined by the regulators to encourage risk
- Regulations to be promulgated by the appropriate regulators within nine months of enactment of DFA

Corporate Governance

- General supervision provisions:
  - *De novo* interstate branching for out-of-state banks wherever permitted for in-state banks
  - Insider lending prohibitions expanded to include derivatives, repos, reverse repos and other forms of securities and lending arrangements

Corporate Governance

- BHC and SLCHC subsidiaries, including functionally regulated subsidiaries, will be subject to examination, regulation and reporting by the primary regulator of the BHC or SLHC

- Reg O will be expanded to exposures associated with derivative transactions, repos, reverse repos and any type of securities lending or borrowing

Corporate Governance

- The FDIA is amended to prohibit purchases or sales of assets to or from an insider except when the transaction is on market terms. If the transaction involves more than 10 percent of the capital and surplus of the bank, there must be approval by a majority of the disinterested members of the board of directors.

Corporate Governance and Risk Management Holding Companies

- DFA provides for the enhanced supervision of BHCs and SLHCs by authorizing the primary regulator authority over all subsidiaries even those that are functionally regulated. Coordination with state and federal regulators is required in order to ease regulatory burden.

Corporate Governance and Risk Management Holding Companies

- The Federal Reserve is required to examine all non-depository subsidiaries, other than those that are functionally regulated, as if they were conducted in the lead insured depository institution

Corporate Governance and Risk Management Holding Companies

- The Federal Reserve is required to coordinate with the state authority and may conduct joint or alternating examinations of the subsidiary

Corporate Governance and Risk Management Holding Companies

- Provisions for public companies:
  - Non-binding "say on pay" vote by shareholders
  - Compensation committees must consist entirely of independent directors
  - Disclosure of comparison between company performance and executive compensation and the ratio of the CEO's compensation to the median of all employees
  - Disclosure and vote on "golden parachutes"
  - "Proxy Access"
  - Disclosure of Chairman and CEO structure

Corporate Governance and Risk Management Holding Companies

- SLHCs that meets all the requirements may become a financial holding company and conduct the same activities

Corporate Governance and Risk Management Provisions

- Provisions for Large BHCs and Significant Nonbanks prudential standards:
  - Capital and leverage limits
  - Liquidity standards
  - Resolution Plan
  - Credit exposure reporting
  - Concentration limits
  - Special "stress test" requirements and reporting

Corporate Governance and Risk Management Provisions

- All publicly traded BHCs or SLHCs with assets of $10 billion or more must establish a risk committee that is responsible for enterprise risk management. The Fed may require publicly traded BHCs with less than $10 billion to also establish a risk committee.

Corporate Governance and Risk Management Provisions

- All financial companies with assets over $10 billion, that are regulated by a primary federal financial regulatory agency must conduct annual stress tests

Questions?