



First Review Summary of the Financial Regulatory Reform Proposal As of June 17, 2009

The administration issued its detailed, 88-page Financial Regulatory Reform plan today with the stated objectives of: (1) Promoting robust supervision and regulation of financial firms; (2) Establishing comprehensive supervision of financial markets; (3) Protecting consumers and investors from financial abuse; (4) Providing the government with the tools it needs to manage financial crises; (5) Raising international regulatory standards and improve international cooperation.

It is important to remember that this announcement is just the first step in a long process of regulatory reform. Most of the components of this proposal will need to be implemented by Congress, which will make significant changes as legislation moves through the House and Senate. That process will begin this summer, but it is not likely to be completed this year. Be assured that MBA will be actively engaged with members of both parties on both sides of Capitol Hill, as well as the administration, as Congress considers reform measures. As the process goes forward, MBA will be consulting with its members to develop policy where needed.

Key Points of Particular Interest – The Plan:

- Creates a broadly empowered new Consumer Financial Protection Agency (CFPA) with authority to regulate mortgage products, assuming from other regulators responsibilities under RESPA, TILA, HOEPA, ECOA, CRA, HMDA and FDCPA;
- Establishes the CFPA's rules as a "floor" not a "ceiling" for additional state laws and allows states to enforce rules against federally chartered banks and other originators;
- Provides authority to CFPA to require originators or securitizers to retain an interest in the credit risk of loans transferred in securities to private investors;
- Authorizes new requirements for originator compensation that would disburse commissions over time based on loan performance;
- Also, authorizes establishment of appropriate duties of care applying to financial intermediaries serving consumers, including a new "duty of best execution" for mortgage brokers; and
- Indicates that administration will be working on its proposal for the future of the GSEs and reporting on that topic to Congress by early next year.

Summary – The Plan would establish: (I) the Federal Reserve as a systemic risk regulator in addition to its other functions; (II) Financial Services Oversight Council, chaired by Treasury and including the heads of the principal federal financial regulators as members; (III) Consumer Financial Protection Agency, an independent entity dedicated to consumer protection in credit, savings, and payments markets; (IV)

National Bank Supervisor, a single agency with separate status in Treasury, responsible for regulation of federally chartered depository institutions taking over functions of the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS); and (V) Office of National Insurance within Treasury to promote national coordination in the insurance sector.

Plan would also maintain: Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) in their roles in the supervision and regulation of state chartered banks, and the National Credit Union Administration (NCUA) for credit unions. Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) would maintain current roles as market regulators.

I. Federal Reserve – Systemic Risk Regulator

- Authority given to Federal Reserve to supervise all firms with potential of threatening financial stability.
 - Federal Reserve Board should have the authority and accountability for consolidated supervision and regulation of Tier 1 FHCs.
 - Legislation will propose criteria that the Federal Reserve must consider in identifying Tier 1 Financial Holding Companies (FHCs).
 - Imposes prudential standards for Tier 1 FHCs – including capital, liquidity and risk management standards – which will be stricter and more conservative than those applicable to other financial firms to account for the greater risks that their potential failure would impose on the financial system.
 - Consolidated supervision of a Tier 1 FHC should be macroprudential in focus - consider risk to the system as a whole.
 - Federal Reserve will propose recommendations by October 1, 2009, to better align its structure and governance with its authorities and responsibilities.
 - Requires accountability by: ensuring banks, nonbanks, and independent mortgage brokers play by the same rules.
 - Increases access by: enforcing the Community Reinvestment Act and fair lending laws and ensuring that underserved consumers and communities have access to prudent financial services, lending and investment.
- Imposing stronger capital and other prudential standards for all financial firms and even higher standards for large, interconnected firms.
 - Treasury will lead a working group to conduct a study of existing regulatory capital requirements for banks and BHCs, including new Tier 1 FHCs – report by December 31, 2009.
 - Treasury will lead a working group to conduct a study of the supervision of banks and BHCs – report by October 1, 2009.
 - Federal regulators to issue standards and guidelines to better align executive compensation practices with long-term shareholder value
 - Does not limit capital and management requirements for FHC to the subsidiary depository institution. All FHCs would be required to meet the capital and management requirements on a consolidated basis.

- Accounting standard setters (the FASB, the IASB, and the SEC) to review standards for more forward-looking loan loss provisioning practices.
- Review of fair value accounting rules to provide fair value information and greater transparency regarding the cash flows management expects to receive by holding investments
- Recommends accounting standard setters make substantial progress by the end of 2009 toward development of a single set of high quality global accounting standards.
- Recommends the modification and improvement of Basel II by refining risk weights applicable to securitized products.
- The plan has a reference to FAS 166 and FAS 167 that would require many securitizations to be consolidated by the originator and deferral of recognition of gain on sale.

II. Financial Services Oversight Council

Creates a new Financial Services Oversight Council of financial regulators to identify emerging systemic risks and improve interagency cooperation with information gathering authority and responsibility for referring emerging risks to the attention of appropriate regulators

III. Consumer Financial Protection Agency (CFPA) Would establish CFPA as an independent agency with broad jurisdiction to protect consumers in consumer financial products and services, CFPA would have authority to:

- Regulate under Truth-in-Lending Act (TILA), Truth-in-Savings, HOEPA, RESPA and other laws, moving authorities from current regulators;
- Enforce, and have jurisdiction over all persons covered by, the statutes that it implements including coordinating enforcement efforts with the states;
- Protect consumers from unfair, deceptive, and abusive practices;
- Addresses a wide range of practices by :
 - Placing tailored restrictions on product terms and provider practices;
 - Promoting simple products for simple consumer choice by requiring firms to offer a “plain vanilla” mortgage product with straightforward terms, while preserving consumer freedom of choice to opt-out for other products, subject to stringent protections;
 - Imposing appropriate duties of care on financial intermediaries, including mortgage brokers;
 - Requiring transparency by: ensuring consumers receive a single, simple, integrated federal mortgage disclosure;
 - Requiring communications with consumers to adequately present risks and benefits of a mortgage product; and requiring timely collection and publication of data on how loans perform;
 - Demanding fairness by requiring mortgage brokers to owe a duty of best execution to avoid conflicts of interest, as well as a duty to determine the mortgages they sell are affordable to borrowers;
 - Banning unfair practices such as “yield spread premiums;”

- Authorizing new compensation requirements for loan officers of banks and brokers to be paid over time based on loan performance;
- Restricting or banning prepayment penalties;
- Requiring loan originators or sponsors of securitizations to retain five percent of the credit risk; and
- Requiring accountability by: ensuring banks, nonbanks, and independent mortgage brokers play by the same rules.

The Plan would also:

- Assign CFPB authority to enforce the Community Reinvestment Act and fair lending laws and ensure that underserved consumers and communities have access to prudent financial services, lending and investment.
- Give Federal Trade Commission better tools and resources for consumer protection, though it appears that some FTC authorities would move to CFPB.
- Expand SEC authority to promote transparency in investor disclosures and new tools to increase fairness for investors.

IV. National Bank Supervisor (NBS)

- NBS to conduct prudential supervision and regulation of all federally chartered depository institutions, and all federal branches and agencies of foreign banks. All companies controlling an insured depository institution be subject to robust consolidated supervision and regulation by the Federal Reserve and be subject to nonbanking activity restrictions of the BHC Act.
- Eliminating the federal thrift charter, but preserving interstate branching rules and apply them to state and national banks.
- Require SEC registration of hedge fund advisers and other private pools of capital.

V. Office of National Insurance

- Establishes within Treasury to promote national coordination in the insurance sector.

Other Significant Recommendations –

Establishes Comprehensive Regulation of Financial Markets

The Plan recommends:

- Enhanced regulation of securitization markets, including new requirements for market transparency, stronger regulation of credit rating agencies, and a require issuers and originators retain a financial interest (five percent) in securitized loans.
 - SEC to continue efforts to increase the transparency and standardization of securitization markets; be given clear authority to require robust reporting by issuers of asset backed securities (ABS); and continue efforts to strengthen the regulation of credit rating agencies. (Regulators to reduce use of credit ratings in regulations and supervisory practices.)

- Credit rating agencies should differentiate the credit ratings they assign to structured credit products from those they assign to unstructured debt. Credit rating agencies should publicly disclose how the risks of structured products differ fundamentally from the risks of unstructured corporate debt.
- Risk-based regulatory capital requirements should appropriately reflect the risk of structured credit products. They should also minimize opportunities for firms to use securitization to reduce their regulatory capital requirements without a commensurate reduction in risk.
- Federal banking agencies to promulgate regulations that: require originators or sponsors to retain an economic interest in a material portion of the credit risk of securitized credit exposures and align compensation of market participants with longer term performance of the underlying loans.
- Creating comprehensive regulation of all over-the-counter derivatives.
 - Creates coordinated regulatory framework to improve transparency and market discipline by: imposing record keeping and reporting requirements on all OTC derivatives; strengthening prudential regulation of all dealers in OTC derivative markets; reduces systemic risk by requiring execution in regulated, transparent venues, cleared by regulated central counterparties.
- Giving new authority for the Federal Reserve to oversee payment, clearing, and settlement systems.
- Harmonization of statutory and regulatory regimes for futures and securities.
- The Office of National Insurance Oversight within the Treasury will support proposals to modernize and improve the system of insurance regulation. This includes increased national uniformity through either a federal charter or effective action by the states.

Provides the Government with the Tools it needs to Manage Financial Crises

The Plan recommends:

- Creating a new resolution regime for nonbank financial institutions failures that pose serious systemic effects. New authority, modeled on the existing authority of the FDIC, allows government to address an institution's failure when systemic risk exists.
- Revising the Federal Reserve's emergency lending authority to improve accountability to require the Federal Reserve Board receive prior written approval from the Treasury for emergency lending under its "unusual and exigent circumstances" authority (Section 13(3) of the Federal Reserve Act).

Raises International Regulatory Standards and Improve International Cooperation

The Plan recommends:

- Encouraging international reforms, including strengthening the capital framework; improving oversight of global financial markets; coordinating supervision of internationally active firms; and enhancing crisis management tools.

Future of the GSEs – Recommends determination of the Future of the GSEs by requiring Treasury, HUD and other government agencies to engage in a wide-ranging initiative to develop recommendations on the future of the GSEs, and the Federal Home Loan Bank system to be released in coordination with the 2011 Budget release.

- Identifies options for GSE reform, including: (i) returning them to their previous status as GSEs with the paired interests of maximizing returns for private shareholders and pursuing public policy home ownership goals; (ii) gradual wind-down of their operations and liquidation of their assets; (iii) incorporating the GSEs' functions into a federal agency; (iv) a public utility model where the government regulates the GSEs' profit margin, sets guarantee fees, and provides explicit backing for GSE commitments; (v) a conversion to providing insurance for covered bonds; (vi) and the dissolution of Fannie Mae and Freddie Mac into many smaller companies.

For more information please contact:

Ken Markison, MBA Associate Vice President and Regulatory Counsel
(202) 557-2930 or kmarkison@mortgagebankers.org

Michael Carrier, MBA Associate Vice President of Secondary Markets
(202) 557-2870 or mcarrier@mortgagebankers.org

George Green, MBA Associate Vice President of Commercial/Multifamily Policy
(202) 557-2840 or ggreen@mortgagebankers.org

Joe Silvia, MBA Senior Public Policy Specialist, Government Affairs
(202) 557-2858 or jsilvia@mortgagebankers.org