

ICBA Summary of Administration's Regulatory Reform Plan

President Obama unveiled his administration's financial regulatory reform proposal, which includes systemic-risk regulation and a resolution mechanism for failing large firms, fills in regulatory gaps, enhances consumer protections through a new agency and makes other changes to the nation's financial regulatory framework. ICBA has prepared the following summary of proposed regulatory reforms. ICBA will work to improve the plan to reflect the concerns of community banks and will continue to provide updates on the plan's progress.

Enhancing Financial Supervision and Regulating Systemic Risk

ICBA has been a strong advocate for enhanced consolidated supervision of "systemically important institutions," including higher capital and liquidity requirements and limits on leveraging. Many of the administration's proposals in this area are consistent with ICBA core principles. The plan would:

- Expand the authority of the Federal Reserve Board to be the systemic-risk regulator and assume accountability for consolidated supervision of systemically important and inter-connected ("Tier 1") financial holding companies. The Fed will maintain its role in setting monetary policy, but lose its consumer protection powers to the new Consumer Financial Protection Agency (see below).
- Create a Financial Services Oversight Council, consisting of the principal financial regulators and the Treasury Secretary, who will act as chair. The council will replace the President's Working Group on Financial Markets and advise the Federal Reserve on systemic risk issues. The council will have broad authority to gather information from any financial firm to identify emerging risks to financial stability, and prepare an annual report to Congress. The council will recommend firms as Tier 1 FHCs that should come under consolidated supervision by the Fed, regardless of whether they own insured depository institutions. Congress must establish criteria that the Fed must consider in identifying Tier 1 firms, but the final identification of such firms will rest with the Fed.
- Subject Tier 1 firms to stricter prudential standards than other BHCs, including higher standards on capital, liquidity and risk management.
 - All FHCs will be required to be "well capitalized" and "well managed" on a consolidated basis to engage in activities under the Gramm-Leach-Bliley Act.
 - A working group led by Treasury will reassess the design and structure of existing regulatory capital requirements for banks and BHCs (including Tier 1 FHCs) and issue findings by Dec. 31, 2009.

- Give the Federal Reserve authority to oversee systemically important payment, clearing and settlement systems, and related activities, and to grant access to the discount window to such systems and firms engaged in related activities.
- Eliminate the thrift charter and merge the Office of Thrift Supervision and Office of the Comptroller of the Currency into a new National Bank Supervisor that will conduct prudential supervision and regulation of federally chartered depository institutions. (ICBA opposes the elimination of the thrift charter and the OTS.)
- Designate the FDIC as the federal regulator of state-chartered institutions. No other changes are proposed for state-chartered institutions or credit unions.
- Close nonfinancial activity loopholes in the Bank Holding Company Act, including the ILC loophole. This has been a strong ICBA position.
- Require regulators to issue standards and guidelines on executive compensation, and give the Securities and Exchange Commission authority to allow shareholders to vote on executive compensation packages.
- Designate Treasury and HUD to lead a study on the future of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and report recommendations to Congress in time for the President's 2011 Budget release (February 2010).

Resolving “Systemically Important” Firms

The administration's proposal also creates a regime for resolving failing bank holding companies and systemically important institutions. The regime would be similar to the one the FDIC now uses for resolving bank failures. Details include:

- If Treasury determines that a systemically important institution is failing, it could appoint the FDIC to act as a conservator or receiver (or the SEC in the case of a broker-dealer or securities firm). The chosen agency would have broad powers to take action with respect to the institution, including transferring all or part of the institution to a bridge institution or other entity.
- The FDIC would have back-up examination authority over BHCs and the authority to obtain any examination report prepared by the Fed with respect to any BHC.

ICBA supports vesting the FDIC with authority to resolve systemically important institutions and supports the establishment of a separate segregated fund to cover the potential and actual FDIC expenses that would come as a result of obtaining broader resolution authority.

Creating a Consumer Financial Protection Agency

ICBA has concerns about the creation of a single, federal Consumer Financial Protection Agency to enforce and regulate consumer financial products and services. Such an agency would separate consumer policy and enforcement from safety and soundness enforcement, when all of these elements must co-exist and be balanced for effective financial services regulation and enforcement. Details of the administration's plan for the CFPS include:

- The new agency will have broad enforcement and regulatory authority over consumer financial products and services. It will regulate all providers of such products and services, including banks and the range of other firms not previously subject to comprehensive federal supervision.
- The agency will be independent of all other financial services agencies and have the sole authority to:
 - write rules across bank and nonbank firms for a level playing field and higher standards;
 - supervise and examine institutions for compliance;
 - enforce compliance through orders, fines and penalties;
 - serve as a floor, not a ceiling, with respect to state laws, and states will be able to adopt and enforce stronger consumer protection rules.
- The agency will have sole authority to interpret and update consumer financial services laws, such as the Truth in Lending Act (TILA), Home Ownership and Equity Protection Act (HOEPA), Real Estate Settlement and Procedures Act (RESPA) and the Truth in Savings Act (TISA).
- The agency will have regulatory and enforcement authority over fair lending laws, such as the Community Reinvestment Act (CRA), Home Mortgage Disclosure Act (HMDA) and the Equal Credit Opportunity Act (ECOA).
- The agency will be tasked with:
 - mandating a new, proactive approach to consumer disclosure;
 - requiring all disclosures and other communications with consumers be reasonable, balanced in their presentation of benefits and clear and conspicuous in their identification of costs, penalties and risks;
 - defining standards for “plain vanilla” loan products that are simple and have straightforward pricing;
 - requiring all providers and intermediaries to offer these less-complicated loan products prominently, alongside whatever other lawful products they choose to offer; and
 - requiring that alternative loan products be subject to more scrutiny and higher penalties for any violations.

- The agency will also have the authority to:
 - ban unfair terms and practices or place tailored restrictions on product terms and provider practices, if the benefits outweigh the costs;
 - impose heightened duties of care on financial intermediaries that reflect reasonable consumer expectations; and
 - ensure that compensation practices do not create conflicts of interest between intermediaries and consumers.

Establishing Comprehensive Regulation of Financial Markets

Many of the recommendations in this section do not require legislation, but can be achieved through regulations by financial services regulators and the Financial Accounting Standards Board.

Risk Regulation of Asset-Backed Securities

ICBA has said that a risk-retention requirement for mortgage-backed securities could be a useful tool in regulating risk associated with the securitization process, if coupled with an exemption from the retention requirement for mortgages subject to comprehensive standard underwriting requirements, such as loans sold to the GSEs or guaranteed by the Federal Housing Administration.

The Obama plan provides:

- Federal banking agencies would issue regulations requiring the originator or sponsor of an asset-backed security to retain a 5 percent interest in the credit risk of the securitized exposures, and prohibit hedging of the retained risk.
- Regulations would be adopted to align compensation of market participants with the longer term performance of the underlying loans by, for example, as FASB has proposed, eliminating immediate recognition of gain on sales at the origination of the securitization process and instead require originators to recognize income over time.
- Fees and commissions paid to mortgage brokers and loan officers, who have no ongoing relationship with the borrower, should be paid over time and reduced if underwriting or asset quality problems emerge.
- The SEC would continue efforts to increase transparency around and standardization of security markets, and it would strengthen regulation of credit rating agencies. Regulators would reduce their reliance on credit ratings wherever possible.

Regulation of OTC Derivatives, Including Credit Default Swaps

ICBA strongly endorses stronger regulation of over-the-counter derivatives because of the central role credit default swaps played in the current financial meltdown.

The administration proposal would require that:

- All standardized OTC derivatives be cleared through regulated central counter parties; and
- All OTC derivatives dealers and firms with large derivatives exposure be subject to comprehensive prudential regulation.

Harmonize Futures and Securities Regulation

The administration's plan also would require the Commodities Future Trading Commission and SEC to make recommendations for changes to statutes and regulations that would harmonize the regulations of futures and securities.

Applying Common-Sense Accounting Reforms

The plan recommends a number of accounting reforms:

- Recognizing that aspects of current accounting standards have been procyclical, FASB, the International Accounting Standards Board and the SEC would review accounting standards to allow banks to employ more forward-looking loan-loss provisioning practices and consider factors that would cause loan losses to differ from recent historical experiences. This would permit banks to build loan loss reserves earlier in the credit cycle.
- Fair value accounting would also be reviewed to identify changes to provide greater transparency about expected investment cash flows. ICBA has strongly supported both of these recommendations and would urge the administration to include the banking regulators in the review process.
- The administration recommends that substantial progress be made by the end of 2009 in developing a single set of high-quality global accounting standards. ICBA believes any convergence of accounting standards globally should not increase complexity or disadvantage domestic small banks or businesses.

The administration's regulatory reform proposals are at the earliest stages. ICBA will work with the administration and Congress to advance key ICBA policy priorities included in the plan while addressing community bank concerns. Look for further ICBA coverage of the administration's proposed reforms.