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Federal Regulatory Alert

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Obama Administration's Regulatory Reform Plan

As you know, President Obama unveiled his administration's financial regulatory reform proposal on Wednesday of last week in the form of a white paper. Treasury Secretary Timothy Geithner testified on the proposal before the Senate Banking Committee last Thursday, but Secretary Geithner's testimony before the House Financial Services Committee the same day was postponed to a later date, due to House floor votes. **The following is an overview of the proposal and a brief summary of some of the key provisions in the proposal, as well as, some initial personal thoughts about the key provisions.**

Overview

As mentioned, the **regulatory reform proposal was released in the form of a white paper.** To the best of our knowledge the **actual bill or bills** to accomplish all of the things in the reform package **have not been released yet. The shear scope, magnitude and volume of this proposal in unbelievable.** It is extremely complex and complicated and some portions of the white paper itself are highly technical and legalistic in nature.

The white paper is either 85 or 88 pages long depending on the version you choose to read. It is difficult to imagine what the length of the actual bill(s) will be to fully address everything mentioned in the white paper. Also, if the white paper is technical and legalistic, it is certain the actual bill(s) will be. **While the white paper contains many details, there are also many details not included and many questions left unanswered.** Further, the white paper calls for quite a number of studies to be done by various parties regarding various issues, with requirements for reports to Congress. Interestingly, a number of the issues specifically identified for study are issues that are already definitively addressed in some detail in the reform proposal. So, if the reform legislation passes quickly as the administration would like, does this raise the prospect for a Reform Bill # 2 once the results of the various studies are known?

The administration has indicated a desire to pass this regulatory reform proposal this year and Barney Frank, the Chairman of the House Financial Services Committee, has indicated an intention to mark up at least the Consumer Financial Protection Agency (See discussion below.) portion of the proposal, if not all of it, before the August recess of Congress. The schedule in the Senate for taking up the proposal is much less clear at this point. **The complexity of the proposal and the fact that the proposal will affect so many different government agencies and their constituencies likely will make it difficult to pass the entire reform package quickly.**

Even though a quick passage of the entire reform proposal would be difficult, we cannot let our guard down. Though many details are yet to come, it is clear that this reform proposal will dramatically affect almost every aspect of a community bank's operation. **We will need all community bankers to be prepared to be engaged in the political process as this legislation moves through the process.**

Regulatory Reform Proposal: Key Provisions for Community Banks

There are a number of positive provisions for community banks included in the proposal. However, there are also quite a number of provisions in the proposal which create great concerns for community banks. Further, some of the provisions which appear to be positive on the surface lack significant details making it impossible to reach a final determination about the favorable nature of those provisions for community banks.

A summary of the key provisions for community banks included in the reform proposal and initial thoughts and observations regarding those provisions follow:

Federal Reserve Established as the Systemic Risk Regulator

The reform 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 would 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 would replace the President's Working Group on Financial Markets and advise the Federal Reserve on systemic risk issues. The council would 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 would 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 would 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 would 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 would 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 grant access to the discount window to such systems and firms engaged in related activities.

Initial Thoughts: ***The creation of a systemic risk regulator and a systemic risk resolution authority (see below) is something for which we have advocated. However, there are a number of issues raised by this proposal that leave uncertainty.*** *First, the proposal seems to be silent on the ability of the FRB to collect fees to cover the cost of supervision of the systemically important institutions. I would assume they would be allowed to collect such fees; however, we would want it to be totally clear that the fees will be assessed and collected only from the systemically important institutions. Second, a working group led by the Treasury would reassess the design and structure of existing capital requirements for all banks and bank holding companies. Third, the proposal indicates that stricter and higher capital, liquidity and risk management standards will be established for systemically important firms. However, it remains to be seen if the establishment of those standards will affect such standards for all other banks. Fourth, the proposal provides the FRB with the authority to oversee systemically important payment, clearing, and settlement systems, and related activities, and to grant access to the discount window to all systemically important firms, which would seem logical and reasonable. However, the proposal also seems to imply that non-bank systemically important firms may be granted direct access to the payment system without going through a bank. The concern with such access for non-banks is obvious.*

Resolution Authority Established for Systemically Important Entities

The details of the proposal include:

- Creation of a regime for the resolution of failing bank holding companies and for systemically important institutions which would be similar to the resolution regime currently used by the FDIC for banks.
- 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.

Initial Thoughts: *It is clear that a systemic resolution authority is needed and we have supported the establishment of such an authority in order to hopefully address the "too big to fail" issue. However,* ***the proposal lacks sufficient clarity in many respects***

as it relates to the FDIC becoming the resolution authority for all systemically important institutions, except broker-dealers and securities firms. *For example, while the proposal specifically says the FDIC would have the authority to collect fees to cover the cost of this new responsibility, it is unclear if those fees will only be assessed on the systemically important institutions and bank holding companies. In addition, the proposal is silent regarding the establishment of a segregated fund to cover the potential and actual cost of the FDIC in resolving bank holding companies and systemically important institutions. Finally, the proposal lacks clarity with regard to how this new resolution responsibility will be kept sufficiently separate from the FDIC's primary function of insuring customer deposits.* ***FDIC insurance coverage is critically important to the competitiveness of community banks and we must be sure the FDIC's new resolution authority function is fully separated and the integrity of the deposit insurance function is maintained.***

Elimination of the Thrift Charter and the Office of Thrift Supervision

The proposal would:

- 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.
- Designate the FDIC or the FRB as the federal regulator of state-chartered institutions, depending on Fed-member versus non-member status. No other changes are proposed for state-chartered institutions or credit unions.

Initial Thoughts: ***There appears to be so much momentum behind the elimination of the OTS, this may be difficult to stop.*** *And while a reasonable case can be made for the continued need for a separate financial institution charter focused on residential mortgage lending, the administration's white paper makes a compelling argument against the retention of the thrift charter.*

If the thrift and national bank charters are consolidated, under the proposal the new consolidated charter would retain the interstate branching powers of the thrift charter. Further, the proposal indicates that ***states would not be able to "prevent de novo branching into states or impose minimum requirements on age of in-state banks that can be acquired by an out-of- state banking firm."*** *Such an elimination of all interstate branching restrictions would have significant implications for Georgia banks.* ***Out-of-state banks would no longer be required to buy a bank to gain initial entry into the state.*** *Also, if the current three year age requirement before a de novo bank can be acquired cannot be imposed on interstate transactions, it is doubtful it could be enforced in regard to intrastate transactions. So, if the reform package passes as proposed, our three year age requirement would go away, due to preemption by federal law.*

The proposal is silent on how mutual thrifts and mutual holding companies would be handled in the new consolidated charter environment. This is something that will have to be specifically addressed, since there are no mutual banks or mutual national bank holding companies. The proposal is also silent about the composition of the FDIC Board of Directors after the elimination of OTS as a separate agency, and therefore the elimination of an FDIC Board seat for the Director of the OTS.

The proposal indicates that further reductions would be made in "the differences associated with multiple remaining bank charters and supervisors" and in the "differences in substantive regulations and supervisory policies applicable to national banks, state member banks, and state non-member banks." ***If all differences between charters are eliminated, it would seem to diminish the value of charter choice and specifically diminish the value of a state charter.*** *While there are limited differences in the powers of Georgia state chartered banks versus those of national banks, there are a number of small, but sometimes significant differences. One example that comes to mind is the secured and unsecured lending limits to one borrower. In some respects the state law is more liberal, while in other respects the federal law for national banks is more liberal.*

Separation of Banking and Commerce

The proposal:

- "Re-affirms and strengthens" Congress' policy position of maintaining a separation of banking and commerce.
- Closes nonfinancial activity loopholes in the Bank Holding Company Act, including the ILC loophole.

Initial Thoughts: ***Maintaining the separation of banking and commerce and eliminating the Industrial Loan Company (ILC) loophole have long been strong policy positions of the CBA of GA. Therefore, this portion of the proposal would appear to be***

good for community banks.

Creation of a Consumer Financial Protection Agency

Details of the reform proposal include:

- The creation of a new, single, federal Consumer Financial Protections Agency to enforce and regulate consumer financial products and services.
- The new agency would have broad enforcement and regulatory authority over consumer financial products and services. It would regulate all providers of such products and services, including banks and a range of other firms not previously subject to comprehensive federal supervision.
- The agency would be independent of all other financial services agencies and have the sole authority to:
    1. write rules across bank and nonbank firms for a level playing field and higher standards;
    2. supervise and examine institutions for compliance;
    3. enforce compliance through orders, fines and penalties; and
    4. **serve as a floor, not a ceiling, with respect to state laws, and states would be able to adopt and enforce stronger consumer protection rules.**
- The agency would 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 would 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 would be tasked with:
    1. mandating a new, proactive approach to consumer disclosure;
    2. 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;
    3. defining standards for "plain vanilla" loan products that are simple and have straightforward pricing;
    4. requiring all providers and intermediaries to offer these less-complicated loan products prominently, alongside whatever other lawful products they choose to offer; and
    5. requiring that alternative loan products be subject to more scrutiny and higher penalties for any violations.
- The agency will also have the authority to:
    1. ban unfair terms and practices or place tailored restrictions on product terms and provider practices, if the benefits outweigh the costs;
    2. impose heightened duties of care on financial intermediaries that reflect reasonable consumer expectations; and
    3. ensure that compensation practices do not create conflicts of interest between intermediaries and consumers.

<u>Initial Thoughts</u>: ***The creation of a federal Consumer Financial Protection Agency (CFPA) is the portion of the regulatory reform proposal that creates some of the greatest concerns.***

The CFPA would have jurisdiction over "all credit, savings and payment products," therefore; this separate federal agency would touch a community bank's entire loan and deposit business. *All consumer policy and enforcement for all of these products would be in a totally separate agency, with separate examination/supervision authority. In addition to the basic concern of adding an additional regulatory agency for banks, this leaves considerable concern about the maintenance of a proper balance between consumer policy and enforcement and safety and soundness enforcement. How would the conflicts between safety and soundness and consumer protection be handled? Will banks simply be left in the middle between the agencies and expected to reconcile irreconcilable differences in policy and/or enforcement?*

The CFPA would have supervisory and enforcement authority over non-banking institutions offering covered financial products, as well. On the surface, this would appear to promote more of a level playing field and be a benefit to community banks. However, ***the proposal states that while the CFPA will have supervisory and enforcement authority over non-banks, "the states should be the first line of defense," for consumers on such institutions. In my view that provides limited comfort that equal supervision and enforcement will actually occur.***

Under the proposal, it appears there would no longer be any preemption of state law that falls into the proposal's extremely

broad category of consumer protection. *The proposal specifically says that states could "adopt stricter laws, as long as, they do not conflict with federal law." The proposal also indicates that the states would "have concurrent authority to enforce the regulations of the CFPA." Finally, the proposal says that* ***even "federally chartered institutions would be subject to nondiscriminatory state consumer protection and civil rights laws to the same extent as other institutions," and*** *that* ***states could "enforce these laws . . . with respect to federally chartered institutions,*** *subject to appropriate arrangements with prudential supervisors." The new National Bank Supervisor would have no ability to preempt state consumer protection laws going forward and apparently would be forced to allow state regulators to become actively involved in the enforcement of consumer protection laws on national banks. This would appear to turn the entire body of OCC opinions, rulings, etc. and the entire body of federal case law on preemption on its ear. The kind of status that previous preemption rulings would have going forward is left unclear, but as a practical matter they would probably have little effect. It would seem that small changes to an existing law that had been previously preempted could invalidate the preemption.* ***One major concern that comes immediately to mind under this type scenario in Georgia is the fact that all banks, including national banks, could again become subject to the Georgia Fair Lending Act, the Georgia predatory lending statute.***

The proposal uses overdraft protection/overdraft privilege plans as an example of the types of products over which the CFPA would have jurisdiction. In the proposal's discussion of overdraft protection/overdraft privilege plans ***the proposal states that "the CFPA would be authorized . . . to regulate overdraft protection more like a credit product,*** *with Truth in Lending disclosures as appropriate." Such a discussion generates major concern in regard to the Georgia interest and usury laws.* ***If overdrafts under an overdraft protection/overdraft privilege type plan are construed to be a loan because the CFPA considers such plans to be a credit product, this would almost certainly result in such overdrafts being considered to be in violation of the Georgia usury statute. This could result in Georgia based banks, including national banks, having to stop offering overdraft protection/overdraft privilege type products to their customers.***

Final Comment
The above discussion should make it clear that there are major concerns with many of the provisions in the administration's regulatory reform proposal. Please keep in mind that the above key provisions are those provisions that would appear to be of the greatest significance for most community banks, based on what we know at this point. **There are certainly other provisions in the proposal of importance to community banks, including among others, the provision requiring the regulators to issue standards and guidelines on executive compensation for financial services firms, requirement for a joint Treasury and HUD study on the future of Fannie Mae and Freddie Mac and "skin in the game" requirements regarding securitized mortgage loans going forward.** As the actual bill(s) are introduced and more details come available, there will likely be additional concerns that come to light. **We will keep you informed of developments as they arise. Please stay informed as the regulatory reform proposal unfolds over the next several months and be prepared to become engaged in the political process. This is a fight that the community banking industry must win. It is a matter of protecting the value of your franchise.**

For more information on the Regulatory Reform Plan, you may want to go to the following links: **Read Administration White Paper.** **Read Treasury Statement with Details of Plan.** **Visit Treasury Webpage on Reg Reform.**

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