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“Overview of the Dodd-Frank Act”

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A. Goals of the Legislation

- Respond to the financial crisis by streamlining the regulatory structure and bringing under scrutiny and supervision all types of financial services companies.
- Focus on the financial system risks created by financial institutions’ activities and imposing appropriate prudential regulation.
- But did the legislation address the real causes of the financial crisis? Fate of Fannie and Freddie not resolved -- role of GSEs to be studied. Regulatory structure arguably more complex post-Dodd Frank.
- Over 2300 pages, affecting almost every aspect of financial regulation, with the need for over 500 new implementing regulations.
A. Goals of the Legislation (cont’d.)

- Lots of studies mandated in areas where no legislative action was taken.
- Many different effective dates, but often effective on the designated “transfer date”, 12 to 18 months after enactment of Dodd-Frank.
- Very little substantive provisions in the Act that directly impact commercial real estate, but the Act dramatically impacts the regulatory environment for all financial services companies.
B. Financial Stability Oversight Council ("FSOC") and the Enhanced Role of the Fed (Title I)

• FSOC formed to provide oversight of all risks created to the U.S. economy from the activities of financial services companies and provide a basis for enhanced prudential regulation. Intended to promote market discipline and respond to emerging threats to the U.S. financial markets. FSOC to monitor the financial services markets for threats to the financial stability of the U.S.; recommend general supervisory priorities and principles; and identify gaps in regulation that could pose risks to financial stability.

• FSOC members to include the Secretary of Treasury as Chair, the heads of all the federal bank regulatory agencies, SEC, and CFTC, the Director of the Federal Housing Finance Agency, the Chair of the NCUA Board, and an independent person with insurance expertise appointed by the President.
B. Financial Stability Oversight Council (“FSOC”) and the Enhanced Role of the Fed (Title I) (cont’d.)

• FSOC will review the activities and interconnectedness of “systemically important financial institutions” (“SIFIs”), which will include banks/BHCs with assets over $50 billion and those financial services companies which the FSOC determines to be SIFIs, after evaluating a number of factors, including the financial services company’s leverage; off-balance sheet exposures; nature of transactions; importance as a source of credit; role as an asset manager; degree to which the company is already regulated by other regulatory agencies; amount and nature of its financial assets; amount and type of its liabilities; including its reliance on short-term funding, etc. All players affecting the financial services markets may be evaluated, including payment processors and other service providers to the industry.

• FSOC has the ability to designate financial institutions as SIFIs that could threaten the financial stability of the U.S. because of their “scope, size, scale, concentration, interconnectedness, or mix of
B. Financial Stability Oversight Council (“FSOC”) and the Enhanced Role of the Fed (Title I) (cont’d.)

[their] activities.” Lots of government power to determine who is a SIFI and how to regulate them.

- SIFI designation said to be dangerous in establishing a “Too Big To Fail” class of financial institutions. Enhanced prudential regulation enough to counteract the moral hazard?

- The Fed (the big winner among the regulatory agencies under Dodd-Frank) is to regulate all designated SIFIs with enhanced prudential regulation, in addition to regulating all BHCs, FHCs and S&L holding companies, and their nondepository subsidiaries, with more stringent regulatory standards than currently in place. Minimum capital levels to be imposed for all, but the Fed can vary the regulations by categories of institutions based on perceived risks. Fed’s prudential
B. Financial Stability Oversight Council (“FSOC”) and the Enhanced Role of the Fed (Title I) (cont’d.)

regulations to include risk-based capital requirements; leverage limits; enhanced risk management requirements; liquidity requirements; resolution plans and credit exposure limits; concentration limits, etc.

- Collins Amendment: Removal of TRUPS from Core Capital. Challenge of finding other sources of core capital. Exclusion for banks with $15 billion in assets or less (only applies to existing TRUPS -- new TRUPS cannot be counted toward core capital).

- Study commissioned on the availability of “contingent capital.”

- Can mandate use of intermediary holding companies to isolate/insulate certain risks.

- “Hotel California” provision -- a BHC may not be able to escape enhanced prudential regulation even if it gives up its depository institution.
C. Living Wills and Orderly Liquidation Authority (Title II)

- SIFIs (and potentially other institutions) to create resolution plans ("living wills” or “funeral plans”) which will serve as roadmaps for the FDIC or a bankruptcy court in winding down their activities in the event of their insolvency. FDIC and Fed to issue regulations regarding the scope/format of the living wills.

- FDIC retains its usual bank resolution authority, but also obtained “Orderly Liquidation Authority.” FDIC able to seize control of and liquidate a “covered financial company” (not an insured depository institution) following a determination that it poses systemic risk to the financial system. OLA will preempt any proceedings under the U.S. Bankruptcy Code. OLA is only a liquidation remedy, and not a reorganization remedy.
D. Regulation of Holding Companies and Depository Institutions (Title VI)

• Holding companies and depository institutions must meet more stringent capital adequacy requirements -- capital requirements to be “counter-cyclical”, rather than pro-cyclical.

• Expanded restrictions on transaction with affiliates (e.g., repos included as covered transactions) and lending limit requirements extended (e.g., includes credit exposure from derivative transactions). National lending limits not imposed on state-chartered banks, but states must amend their laws to include derivative transactions in calculating the lending limits.

• Also, expanded limits on lending to insiders/Reg O (e.g., loans may include securities lending transactions) and limitations on purchases of assets from insiders (on market terms and with the approval of the majority of non-interested directors of a bank for transactions more than 10% of the capital stock and surplus of the bank).
D. Regulation of Holding Companies and Depository Institutions (Title VI) (cont’d.)

- Banks subject to enforcement orders prohibited from converting/flippping their charters.

- Additional conditions for expanded financial activities (both the depository institution and its holding company must be well-capitalized and well-managed).

- Concentration limit of 10% for large firms may be established -- cannot acquire another company if after consummation, the acquirer’s total consolidated liabilities would exceed 10% of the aggregate consolidated liabilities of all financial firms.

- Formalization of the “source of strength” doctrine for all depository institution holding companies and controlling parties of a depository institution.
D. Regulation of Holding Companies and Depository Institutions (Title VI) (cont’d.)

• Volcker Rule. Places limitations on ability of banks to engage in proprietary trading and make investments in or sponsor private equity and hedge funds.

• Risk Management. Publicly traded BHCs with assets of $10 billion or more and non-bank financial holding companies supervised by the Fed are required to establish a board-level risk committee. Risk committee would be required to:
  • Oversee the enterprise-wide risk management practices of the organization;
  • Include a number of independent directors determined by the Fed, based on the nature of operations, size of assets and other criteria; and
  • Include at least one risk management expert with experience in identifying, evaluating and managing risk exposure of large, complex firms.
D. Regulation of Holding Companies and Depository Institutions (Title VI) (cont’d.)

• Three-year moratorium on granting certain “nonbank” charters -- e.g., industrial banks. GAO study of institutions excepted from definition of “bank” under the BHCA, e.g., industrial banks -- evaluate with respect to safety and soundness.

• Fed given the authority to supervise “functionally regulated subsidiaries” (backing off from the GLBA rubrick).

• Interstate Branching Capability for State Banks. With FDIC action, state banks will be able to branch interstate on the same basis as national banks (look to host state restrictions).

• Elimination of Reg Q restrictions on paying interest on demand deposit accounts. Long overdue, but banks will be chasing funds by competing on rates.
E. OTS Abolished, But Thrift Charter Retained (Title III)

• OTS is be abolished, but not the thrift charter itself.
• OCC to regulate thrifts, and the Fed to regulate S&L holding companies and their non-depository subsidiaries.
• HOLA and existing regulations will remain in place, along with existing OTS orders, resolutions, agreements, etc.
• FSBs retain their interstate branching authority, but their preemption authority is diminished.
• If thrift doesn’t meet its QTL test, faces restrictions on paying dividends.
• S&L holdco will be subject to specific capital requirements and other prudential regulation, as well as to a formal “source of strength” requirement. S&L holdco subject to the same regulatory requirements as imposed on FHCs (well-managed, well-capitalized, etc.).
F. Deposit Insurance Assessments and other Deposit Insurance Changes

- Changes the deposit assessment base. Assessments now will be based on average total consolidated assets minus average tangible equity, not just total domestic deposits. Will result in higher premiums assessed on banks with more than $10 billion in assets.

- Permanent increase to $250,000 insurance coverage level per person across all accounts at a given bank.

- Extends the Transaction Account Guarantee Program for non-interest bearing accounts for two years, but excludes low-interest NOW accounts.
G. Preemption (Title X)

- State consumer laws that do not directly or indirectly discriminate against national banks and FSBs are preempted if:
  - Application of the state law would have a discriminatory effect on the national bank or FSB when compared to its effect on state banks;
  - The law meaningfully interferes with the ability of the national bank or FSB to engage in the business of banking (Barnett Bank v. Nelson standard); or
  - The state law is preempted by a federal law other than Dodd-Frank.
H. Consumer Financial Protection Bureau (the “Bureau”) (Title X)

- Creates a new agency, the Bureau, as an independent agency within the Fed, with very ample fixed funds provided from the Fed’s budget (e.g., 12% of the Fed’s total operating expenses). Will establish regional offices and hire personnel. Existing consumer protection personnel from other agencies to be transferred to the Bureau.

- The Bureau will have sweeping powers over the regulation of “consumer financial services and products,” which are very broadly defined (but do not include securities products).

- Bureau to have autonomous and primary authority to promulgate consumer financial protection rules, although it will coordinate its rule-making efforts with other agencies. FSOC with a two-thirds vote could set aside a Bureau regulation if it would put the safety and soundness of the banking system or the stability of the U.S. financial system at risk (very high hurdle).
H. Consumer Financial Protection Bureau (the “Bureau”) (Title X) (cont’d.)

- Will have regulatory authority in the consumer protection area over a very wide variety of banks and nonbank financial services companies (auto dealers excluded).
- Special focus on fair and equitable access to credit for all consumers.
- Special focus on centralizing consumer complaints through a consumer hotline and tracking those complaints.
- Carve-out from Bureau’s enforcement and examination for banks and credit unions with $10 billion or less in assets. Smaller institutions will be examined for consumer protection compliance by their primary regulator instead of the Bureau, but still must comply with the regulations issued by the Bureau and may be required to file reports to the Bureau.
- Will Bureau’s regulations move to “plain vanilla product” standards as originally proposed? Deviations from the articulated plain vanilla product would have required the prior approval of the Bureau.
I. Interchange Fees

• Gives regulatory authority to the Fed over debit card payment fees; aimed at reducing the interchange fees imposed on merchants. Fed would be required to determine what constitutes “reasonable and proportional fees” for debit card transactions.

• Card issuers with less than $10 billion in assets are exempt from the rules, but many commentators believe that the imposition of the interchange rules will generally impact the pricing of all debit card transactions. Networks are likely to apply the lowest rate permitted to all cards, rather than allowing different rates. Banks will search for ways to make up the fees by increasing bank fees in other areas.

• Exclusivity arrangements between an issuer and a network prohibited. Will require banks to display multiple network logos on their cards.
I. Interchange Fees (cont’d.)

- Retailers will be allowed to offer consumers a discount for using cash, a check or a debit card, instead of a credit card. Retailers would also be allowed to require a minimum purchase before they will accept a debit or credit card transaction.
J. Retention Requirements for Securitized Pools

• Issuers of securitized pools required to keep some “skin in the game,” i.e., a 5 percent risk retention requirement, but regulators can grant an exemption from this skin requirement for pools with low-risk residential mortgage loans.
K. Mortgage Lending Requirements (Title XIV)

• Aimed at correcting predatory and abusive mortgage lending practices.
• Yield spread premiums eliminated (lenders no longer able to pay brokers a commission based on the interest rate applied to a loan).
• Closing costs must be paid in full upfront or all rolled costs into the loan (no partial payment of costs at closing).
• Prepayment penalties are limited (e.g., long term fixed rate loans) or prohibited (e.g., large balloon loans), depending on the type of loan.
• Lender required to do a suitability test to determine that the borrower can afford the monthly mortgage payments, along with the insurance, taxes and assessments. If adjustable rate loan, lender has to determine that the borrower can afford the highest possible rate under the loan.
• Borrower entitled to receive a copy of the credit score that the lender used to make the loans.
L. Insurance Regulation

- State regulatory scheme preserved, but a Federal Insurance Office, with a federal insurance czar, established within the Treasury to monitor and study insurance product risks to the stability of U.S. markets.
- Individual with insurance experience must be appointed to FSOC.
M. Corporate Governance Changes

• “Say on Pay” Requirements. Publicly held companies must provide shareholders with a nonbinding vote on executive compensation and golden parachutes.

• Publicly held companies must have executive compensation committees with independent members, who retain impartial compensation consultants and advisors.

• Prohibits the exchanges from listing companies that do not have clawback provisions in their compensation agreements.

• Prohibits brokers from voting on the election of directors, executive compensation or other significant matters without instruction from the beneficial owners of the underlying securities.

• Whistleblowers - greater incentives and protections for whistleblowers.
N. Other Provisions

• New regulation of the credit reporting agencies, including examination and de-licensing authority. Each federal agency must remove any regulatory reference to, or requirement of reliance on, credit ratings, and must substitute its own credit-worthiness standards. To the extent feasible, the agencies should seek uniform standards.

• New broker dealer requirements, including imposition of a fiduciary requirement.

• Registration of many U.S. hedge funds/private investment firms over a certain size.
N. Other Provisions (cont’d.)

- Restriction on derivatives -- “Lincoln push out provision” effectively prohibits depository institutions from conducting derivative activities in the institution itself. Other types of hedging activities permitted in the institution.

- Many, many other provisions.
O. Competition with Non-US Institutions

- Provisions incent funds and other financial operations to move offshore.
- Interplay of Dodd-Frank requirements with Basel III requirements.
P. Outlook for the Years Ahead

• Greater capital and liquidity standards. Capital is king. Well-capitalized banks will eat troubled institutions.

• Generally tougher prudential standards and tougher enforcement stance by regulators.

• More compliance requirements, resulting in higher compliance costs, straining available resources.

• More layers of state standards because of the diminished federal preemption standard. States incented to issue more regulations.

• Disparate impact of the regulatory changes, depending on the size of the institution.
P. Outlook for the Years Ahead (cont’d.)

- Diminishment of the thrift charter, restrictions on charter conversion if under an enforcement action).

- Outlook: Tough environment for U.S. banking industry. Anticipate weaker earnings, more consolidation in the industry and competitive losses to foreign competitors.
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