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Summary of Obama's Financial Regulatory Reform Proposal

On June 17, 2009, President Obama unveiled his administration's financial regulatory reform proposal. In conjunction with industry affiliate national associations—the American Bankers Association (ABA) and the Independent Community Bankers Association (ICBA)—the IBA has prepared the following summary of the proposed regulatory reforms.

The plan includes the following provisions:

- 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.
- Expand the authority of the Federal Reserve Board to be the systemic-risk regulator and assume accountability for consolidated supervision of systemically important and interconnected ("Tier 1") financial holding companies. The Fed will maintain its role in setting monetary policy, but will 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 will 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 will 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 will 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.
- Designate the FDIC as the federal regulator of state-chartered institutions.
- Close nonfinancial activity loopholes in the Bank Holding Company Act, including the ILC loophole.
- 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).

(Continued next page.)

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.

Details of the administration's plan for the Consumer Financial Protection Agency 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.

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.

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.

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 regulations.
- 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.

Finally, the plan recommends a number of accounting reforms:

- 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.
- The administration recommends that substantial progress be made by the end of 2009 in developing a single set of high-quality global accounting standards.

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