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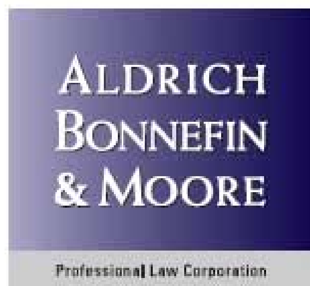

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DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") was signed into law by President Obama July 21, 2010. This Act will implement the most significant financial regulatory reforms since the Great Depression. Although the Act will have many effects, the following are a number of the most notable and controversial changes which will be taking place in the months and years to come.

Funding of the Bill (FDIC Ratio Change)

The Act sets the minimum reserve ratio, designated by the Federal Deposit Insurance Corporation (FDIC) for any year, at 1.35 percent of estimated insured deposits, or the comparable percentage of the assessment base. The FDIC will be required to "take such steps as may be necessary" to reach this ratio by September 30, 2020. The effect of such assessments on depository institutions with total consolidated assets of less than $10 billion will be offset such that the effect of meeting the reserve ratio is borne more heavily by those insured depository institutions with total consolidated assets of $10 billion or greater. Section 334.

TAG/FDIC $250,000 Limit

The Act amends the Federal Deposit Insurance Act (FDIA) to reflect a permanent increase in deposit insurance from $100,000 to $250,000. This increase will retroactively apply to depositors in any institution for which the FDIC was appointed as receiver or conservator on or after January 1, 2008, and before October 3, 2008. The Federal Credit Union Act has also been amended to reflect a permanent increase in share insurance from $100,000 to $250,000. Section 335.

The Act also amends the FDIA to provide for FDIC insurance of the "net amount that any depositor at an insured depository institution maintains in a noninterest-bearing account." Additionally, the Act amends the Federal Credit Union Act to provide for NCUA insurance of the "net amount that any member or depositor at an insured credit union maintains in a noninterest-bearing transaction account." Section 343.

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Collins Amendment

The Collins Amendment, Section 171, imposes risk-based and leverage capital standards, currently applicable to U.S. insured depository institutions, on U.S. bank holding companies, including U.S. intermediate holding companies of foreign banking organizations, thrift holding companies and systemically important nonbank financial companies. One of the most notable effects of the Collins Amendment is that it eliminates trust preferred securities as an element of Tier 1 capital, although existing trust preferred securities are grandfathered for some institutions.

Minimum Leverage Capital Requirements

Federal banking agencies will be required to establish minimum leverage capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and supervised nonbank financial companies, which must not be less than the generally applicable leverage capital requirements that will serve as a floor. The term "generally applicable leverage requirements" means the minimum ratio of Tier 1 capital to average total assets, regardless of total consolidated asset size or foreign financial exposure, and includes the regulatory capital components in the numerator and average total assets in the denominator of that capital requirement, as well as the required ratio of numerator to denominator. "Supervised nonbank financial companies" are nonbank financial companies that are supervised by the Federal Reserve Board.

Minimum Risk-Based Capital Requirements

Federal banking agencies will also establish "minimum risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and supervised nonbank financial companies," which cannot be less than the generally applicable risk-based capital requirements. The term "generally applicable risk-based capital requirements" means the risk-based capital requirements, regardless of total asset size or foreign financial exposure, and includes the regulatory capital components in the numerator and the risk-weighted assets in the denominator of those capital requirements, as well as the required ratio of numerator to denominator.

Exceptions and Exclusions

Bank holding companies under $500 million are exempt from the Collins Amendment. The Collins Amendment also will not apply to (i) debt or equity instruments issued to the United States or any agency or instrumentality thereof prior to October 4, 2010, pursuant to the Emergency Economic Stabilization Act of 2008 (such as TARP preferred securities), (ii) any Federal home loan bank, or (iii) any small bank holding company that is subject to the Small Bank Holding Company Policy Statement of the Federal Reserve, as in effect May 19, 2010.

For debt or equity instruments issued prior to May 19, 2010 by depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010, the capital deductions required for other institutions will not be required.

Volcker Rule

The Volcker Rule, Section 619 of the Act, prohibits banking entities from engaging in proprietary trading or acquiring or retaining any equity, partnership, or other ownership interest in or sponsoring a hedge fund or private equity fund. Nonbank financial companies which do either of these things will be subject to additional capital requirements for and additional quantitative limits with regards to such action.

Permitted Activities

The Volcker Rule also provides a list of permitted activities, which include:

- Purchasing and selling, acquiring, or disposing of obligations of the United States, or any agency thereof, obligations, participations, or other instruments issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal home loan bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution chartered under the Farm Credit Act of 1971, and obligations of any State or of any political subdivision thereof;
- Purchasing, selling, acquiring, or disposing of securities and certain other instruments in connection with underwriting or market-making-related activities, to the extent that any such activities are designed not to exceed the reasonable expected near term demands of clients, customers or counterparties;
- Risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts or other holdings;
- Purchasing, selling, acquiring or disposing of securities and certain other instruments on behalf of customers;
- Investing in one or more small business investment companies, investments designed primarily to promote the public welfare, or investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure;
- Purchasing, selling, acquiring, or disposing of securities and other instruments by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company, provided that these activities by the affiliate are solely for the general account of the regulated insurance company, so long as the activity is conducted in compliance with applicable insurance company investment laws and regulations;
- Organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and in any manner selecting or controlling a majority of the directors, trustees or management of the fund, including any necessary expenses, but only if certain conditions are met;
- Proprietary trading conducted by the banking entity, provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under U.S. or state laws;

- Acquiring or retaining any equity, partnership or other ownership interest in or sponsoring a hedge fund or a private equity fund by a banking entity solely outside of the United States, provided that no ownership interest in the hedge fund or private equity is offered for sale or sold to a U.S. resident and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under U.S. or state laws; and
- Such other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) determine would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

Finally, these permitted activities may not involve or result in a conflict of interest between the banking entity and its clients, result in a material exposure to high-risk assets or trading strategies, threaten the safety and soundness of the banking entity, or threaten the financial stability of the United States.

Hedge Funds and Private Equity Funds

The Volcker Rule, subject to certain exceptions, generally prohibits bank entities from acquiring or retaining any equity, partnership or other ownership interest in or sponsoring any hedge fund or private equity fund.

De Minimis Exception

Banking entities will be permitted to "make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers . . . for the purposes of establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors or making a de minimis investment." Nevertheless, despite this de minimis exception, the banking entity should actively seek unaffiliated investors to reduce or dilute the investment of the banking entity. Additionally, such investments must, no later than one year following the date of establishment of the fund, be reduced through redemption, sale, or dilution to an amount that may not exceed three percent of the total ownership interests of the fund, and "be immaterial to the banking entity." But in no case may the banking entity's collective interest in such funds exceed three percent of its Tier 1 capital. In computing Tier 1 capital, "the aggregate amount of the outstanding investment by a banking entity . . ., including retained earnings, shall be deducted from the assets and tangible equity of the banking entity, and the amount of the deduction shall increase commensurate with the leverage of the hedge fund or private equity fund."

Banking Entities Serving as Investment Managers, Advisers, or Sponsors

The Volcker Rule also prohibits banking entities serving directly or indirectly as the investment manager, adviser, or sponsor to a hedge fund or private equity fund, and any affiliates of such entities, from entering into transactions with the fund or any other hedge fund or private equity fund controlled by such fund, that would qualify as a covered transaction under Section 23A of the Federal Reserve Act. For purposes of determining whether a transaction qualifies as a covered transaction under Section 23A, the banking entity and its affiliate are treated as if they

were a member bank and the hedge fund is treated as an affiliate of the banking entity. The same approach applies in determining whether the transaction is subject to Section 23B of the Federal Reserve Act. The banking entity and its affiliate will be treated as if they were a member bank and the hedge fund is treated as an affiliate of the banking entity.

The Board may permit a banking entity to enter into any prime brokerage transaction with any hedge fund or private equity fund in which a hedge fund or private equity fund managed, sponsored, or advised by such banking entity has taken an equity, partnership, or other ownership interest, if certain requirements are met. A prime brokerage transaction will be subject to Section 23B as if the counterparty were an affiliate of the banking entity.

Relaxation of Branching Rules

The Act allows a state or national bank to establish and operate a de novo branch in a State other than the bank's home State, where "the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State." Section 613. For example, a California-based bank (either state or national) may establish a de novo branch in Nevada provided that Nevada's law would permit a bank chartered in Nevada to establish such a branch.

The Act also allows a savings association that becomes a bank to continue operating any branch or agency it operated immediately before becoming a bank and to establish, acquire and operate additional branches and agencies at any location within any State in which it operated a branch immediately before becoming a bank, if the law in that State would permit establishment of the branch if the bank were a State bank chartered by that State. Section 341.

Merger of OTS and OCC (and Preservation of the Thrift Charter)

The Act abolishes the Office of Thrift Supervision (OTS) and transfers the powers of the OTS to the Office of the Comptroller of the Currency (OCC), the FDIC, and the Federal Reserve Board. Title III, Subtitles A and B.

Powers Transferred to the Board of Governors

All functions of the OTS relating to the supervision of any savings and loan holding company and any non-depository institution subsidiary of a savings and loan holding company, and all rulemaking authority relating to savings and loan holding companies, will be transferred to the Federal Reserve as well as all related powers, authorities, rights and duties that were vested in the OTS. Also transferred to the Fed is the OTS's rulemaking authority under Section 11 of the Homeowners' Loan Act (HOLA), "relating to transactions with affiliates and extensions of credit to executive officers, directors, and principal shareholders and under Section 5(q)" of HOLA relating to tying arrangements. Section 312.

Powers Transferred to the OCC

All functions and rulemaking authority of the OTS relating to Federal savings associations will be transferred to the OCC. Section 312.

Powers Transferred to the FDIC

All functions of the OTS relating to state savings associations are transferred to the FDIC, which succeeds to all related powers, authorities, rights and duties. Section 312.

Impact of the Transfer on Actions and Proceedings

The Act allows for the substitution of the appropriate agencies for the OTS in actions or proceedings that are commenced before the OTS is abolished. Orders, resolutions, determinations, agreements, regulations and other advisory materials issued by the OTS in the performance of its functions which were in effect on the day before the transfer date, will continue to be effective and enforceable by or against the Fed,, OCC or the FDIC – depending upon which agency takes over that particular function – until modified, terminated or superseded with applicable law by that entity. Section 316.

Impact of the Transfer on Regulations

The FRB, the OCC and the FDIC are required to publish (no later than the transfer date) in the Federal Register a list of the regulations that will be continued and enforced. Any regulations proposed by the OTS before the transfer date but not yet published as final by that date, will be deemed to be proposed regulations of the OCC or the FRB. Those interim or final regulations of the OTS, published before the transfer date, will become effective as a regulation of the OCC or the FRB, unless modified, terminated or superseded. Section 316.

Assessments and Fees

The Act also makes changes regarding compensation of examiners, funding of the OCC, funding of the Federal Reserve, and collection of FDIC examination fees. These amendments will allow the OCC to collect an assessment, fee, or charge from certain entities, the FRB to collect assessments, fees or other charges from certain companies (bank holding companies (as well as savings and loan holding companies) with total consolidated assets of $50 billion or more, and supervised nonbank financial companies), and the FDIC to charge the cost of conducting any regular or special examination of certain depository institutions and entities. Section 318.

Regulation Q

The Act repeals the prohibition on payment of interest on demand deposits set out in Section 19(i) of the Federal Reserve Act effective one year after the date of enactment of the Act (which will be about July 21, 2011). Section 627.

Derivatives

Title VII of the Act is dedicated to regulating derivative transactions. Derivative transactions are categorized as either “swaps,” subject to primary regulation by the CFTC, “security-based swaps,” subject to primary regulation by the SEC, or “mixed swaps,” subject to regulation by the CFTC and the SEC, although many of the requirements set forth for “swaps” and “security-based swaps” are nearly indistinguishable.

The most significant elements of this title are mandatory clearing requirements and the transfer of most swap activities from banks to bank affiliates.

Clearing Requirements

The Act limits participation by adding a clearing requirement, making it unlawful for "any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market." Therefore, in order to engage in a swap that is required to be cleared, a person must submit the swap for clearing to a derivatives clearing organization. Sections 723, 763.

Derivatives clearing organizations will be required to submit to the appropriate Commission each swap, or group, category, type, or class of swaps it plans to accept for clearing and provide the required notice to its members. However, these clearing requirements will not apply to a swap if one of the counterparties to the swap is not a financial entity, is using swaps to hedge or mitigate commercial risk, and notifies the appropriate Commission as to how it generally meets it financial obligations associated with entering into non-cleared swaps. Nevertheless, in such a case, the counterparty will have the option to clear.

There is the potential for grandfathering under the clearing requirements through the submission of a petition to the CFTC within 60 days of the enactment of this Act. The CFTC will consider the petition and may allow the person to continue operating under 7 USC Section 2(h), as in effect the day before the enactment of the Act, for no longer than one year.

The appropriate Commission will review on an ongoing basis each swap or group, category, type or class of swaps to determine whether the swap or group, category, type or class of swaps, should be required to be cleared. The appropriate Commission will also be required to consider whether small banks, savings associations, farm credit system institutions and credit unions with $10 billion or less in total assets should be exempt from clearing requirements.

Transfer of Swap Activities to an Affiliate

The Act prohibits federal assistance to swaps entities with respect to swap, security-based swap, or other activity of a swaps entity. However, this prohibition will not extend to insured depository institutions if the following conditions are met: (a) if the institution establishes an affiliate which is a swaps entity, (b) the institution is part of a bank holding company or a savings and loan company supervised by the Federal Reserve, and (c) the swaps entity affiliate complies with Sections 23A and 23B of the Federal Reserve Act (which govern affiliate transactions) and any other such requirements imposed by the SEC. Section 716.

The prohibition against federal assistance will not apply to certain limited swaps activities, including:

- Hedging and other similar risk-mitigating activities directly related to the insured depository institution's activities; and
- Acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank, except where the institution is acting as a swaps entity for credit default swaps, including swaps or

> security-based swaps referencing the credit risk of asset-backed securities, unless such swaps or security-based swaps are cleared by a derivatives clearing organization or a clearing agency registered, or exempt from registration, as a derivatives clearing organization or clearing agency.

To the extent an insured depository institution qualifies as a swaps entity and therefore is subject to the prohibition against federal assistance, the institution's primary federal regulator will be required to establish a transition period during which the institution must divest the swaps entity or cease the activities that require registration as a swaps entity. The transition period can be up to 24 months, with the possibility of a one-year extension. Thereafter, the prohibition against federal assistance will only apply to swaps or security-based swaps entered into by the institution after the end of the transition period.

Additional Notable Requirements

Registration and Regulation of Swap Dealers and Major Swap Participants

Swap dealers and major swap participants will be required to register with the CFTC, regardless of whether the person is also a depository institution or is registered with the SEC as a security-based swap dealer or major security-based swap participant. Each registered swap dealer and major swap participant must, among other duties, maintain daily trading records of its swaps and all related records, as well as daily trading records for each counterparty in a manner and form identifiable with each swap transaction. Sections 731, 764.

Swap dealers and major swap participants for which there is a prudential regulator will be required to meet minimum capital and minimum initial and variation margin requirements as prescribed by the regulator. Swap dealers and major swap participants that do not have prudential regulators will need to meet such minimum capital and minimum initial variation margin requirements as are prescribed by either the SEC or CFTC.

Special requirements are also imposed on swap dealers acting as advisors and those swap dealers which are counterparties to "special entities."

Registration of Swap Execution Facilities

The Act requires registration of swap execution facilities as a swap execution facility or a designated contract market. Such facilities may make any swap available for trading and facilitate trade processing of any swap. However, swap execution facilities may not list for trading or confirm the execution of any swap in an agricultural commodity, unless such swap is otherwise allowed by the appropriate Commission. Sections 733, 763.

International Harmonization

The CFTC, SEC, and prudential regulators will consult with foreign regulatory authorities to create consistent international standards for swaps, security-based swaps, swap entities, etc. Section 752.

Financial Stability Oversight Council

In attempt to prevent a repeat of the 2008 financial meltdown, a Financial Stability Oversight Council (the "Council") is formed in Title I, Subtitle A. Title VIII establishes the framework in which the Council and other Federal regulators are to supervise payment, clearing and settlement activities.

The Council, acting through the Office of Financial Research, may require a nonbank financial company or bank holding company to submit periodic and other reports for the purpose of assessing the extent to which a financial activity or financial market in which that company participates, or the company itself, poses a threat to the financial stability of the United States.

Requiring Supervision of a Nonbank Financial Company

The Council, by a vote of at least two-thirds of the members, including an affirmative vote by the Chairperson, may determine that a U.S. nonbank financial company, or a foreign nonbank financial company with substantial assets or operations in the United States, must be supervised by the Federal Reserve Board, if the Council determines that material financial distress at the U.S. nonbank financial company or the foreign nonbank financial company would pose a threat to the financial stability of the United States. Section 113.

Requiring Supervision of a United States Company (Anti-Evasion Provision)

The Council, on its own initiative or at the request of the Federal Reserve Board, may determine by a vote of at least two-thirds of the members, including an affirmative vote by the Chairperson, that: (a) material financial distress at a company incorporated or organized within the United States or one of its States, or in another country, where the company's financial activities in the United States would pose a threat to the financial stability of the United States based on the considerations set forth in the Act; (b) the company is organized or operates in such a way as to evade the application of Title I of the Act; and (c) such financial activities should be supervised by the Federal Reserve Board. Upon making this determination, the Council must submit a report to Congress detailing the reasons for reaching this determination. Section 113.

The company subject to this determination may establish an intermediate holding company in which the financial activities of it and its subsidiaries shall be conducted in compliance with any regulations or guidance provided by the FRB. This intermediate holding company must be subject to the supervision of the FRB. Section 113.

Recommendations Regarding Prudential Standards and Reporting Requirements

The Council may make recommendations to the Federal Reserve Board regarding the establishment and refinement of prudential standards and reporting and disclosure requirements applicable to nonbank financial companies that are under the FRB's supervision, and large, interconnected bank holding companies. These standards may be more stringent than those that apply to other nonbank financial companies and bank holding companies that do not present the same level of risk to the financial stability of the United States. These standards may also increase in stringency depending upon the considerations set forth in the Act. However, these recommended standards will be inapplicable to any bank holding company with total

consolidated assets of less than $50 billion. Additionally, the Council may recommend that a higher threshold be adopted for any particular standard. Section 115.

The Council may require a bank holding company with total consolidated assets of $50 billion or greater or a supervised nonbank financial company, and any of their subsidiaries, to submit certified reports to keep the Council informed as to a list of issues stated in the Act. Section 115.

Requiring Supervision of Certain Bank Holding Companies

If a bank holding company having total consolidated assets equal to or greater than $50 billion as of January 1, 2010, and which received financial assistance under or participated in the Capital Purchase Program established under the Troubled Asset Relief Program (TARP), or any successor entity to such a bank holding company, ceases to be a bank holding company at any time after January 1, 2010, the entity will be treated as a supervised nonbank financial company. Section 117.

Where the Federal Reserve Board determines that a bank holding company with consolidated assets of $50 billion or more or a supervised nonbank financial company poses a serious threat to the financial stability of the United States, it may take mitigatory action. Such action requires a vote of at least two-thirds of the Council members. Mitigatory action is requiring the entity to do any of the following: (1) to terminate one or more activities; (2) to impose conditions on the manner in which one or more activities are conducted; or (3) if either of the previous actions are considered by the FRB to be inadequate, to sell or transfer assets or off-balance sheet items to unaffiliated entities. Section 121.

Determining the Systemic Importance of Financial Market Utilities

The Council will determine the current or likely systemic importance of financial market utilities ("Utility") or payments, clearing or settlement activities (collectively referred to as "Activity"). Section 804. A Utility is "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person." Section 803. However, the Act excludes many entities from the definition of a Utility. The entities that are excluded from being a Utility include designated contract markets, registered futures associations, and any broker, dealer, transfer agent or investment company. Section 803.

A Utility or Activity is systemically important if its failure could threaten the American financial system's stability. Upon determining systemic importance, the Council will consider: (1) the amount of financial transactions; (2) exposure to the entity's counterparties; (3) its connection with other financial market Utilities or Activities; (4) the effect of its collapse on the financial system; and (5) any other factors that the Council considers pertinent. Section 804. Essentially, the larger the financial institution grows, the more probable it is that the institution will come under the Council's and the Federal Reserve Board's scrutiny.

Designated Financial Market Utilities

Once designated of systemic importance, a Utility must comply with risk management standards put forth by the FRB, in consultation with the Council and appropriate supervisory agencies, except for designated clearing entities, which must comply with standards created by the CFTC and the SEC, in consultation with the FRB and the Council. Section 805.

Designated Utilities are subject to examination at least once a year by the appropriate Supervisory Agency. Section 807. The term "Supervisory Agency" refers to any Federal agency that has primary jurisdiction over that designated Utility under Federal banking, commodity futures or securities laws, such as the SEC, the CFTC, the appropriate Federal banking agency or the Federal Reserve Board. Section 803. The Supervisory Agency can inflict the same enforcement authority given in subsections (b) through (n) of Section 8 of the Federal Deposit Insurance Act upon a designated Utility regardless of whether that Utility is an insured depository institution. Section 807. Accordingly, nonbank financial companies are in many ways subject to the same enforcement authority of the Supervisory Agencies as insured depository institutions. In addition, the designated Utility must give notice to the Supervisory Agency 60 days before implementing any major change in its rules, procedures or operations, and the Supervisory Agency can block such change by objecting to it. Section 806.

Notwithstanding the title of systemic importance, the Board of Governors may authorize a Federal Reserve Bank to establish an account, offer services, provide discount and borrowing privileges, and pay earnings on balances of designated Utilities. Section 806. Not only is the designated Utility subject to examination, but any affiliated or non-affiliated third party that handles an integral service of that Utility may also be subject to such examination. Section 807.

Financial Institutions Engaged in Designated Activities

If a financial institution is engaged in an Activity that is designated as systemically important, the financial institution must comply with the standards jointly created by the Council, the Board of Governors, the CFTC and the SEC, which will be enforced through examination by the appropriate financial regulator. The term "financial institution" includes depository institutions, credit unions, brokers, dealers, investment companies, insurance companies, and investment advisors.

Bureau of Consumer Financial Protection

In order to regulate any person who offers or provides personal, family or household financial products or services, Title X establishes an autonomous watchdog – the Bureau of Consumer Financial Protection (the "Bureau") – within the Federal Reserve to enforce and create "Federal consumer financial laws." Section 1101. Both banks and nonbanks are subject to any rule, regulation or guideline created by the Bureau. The *only* authority the Federal Reserve Board has over the Bureau is the authority to delegate examinations regarding compliance with Federal consumer financial laws. Section 1012. Outside of the Council's power to reject the Bureau's rules in extremely limited situations, it is within the Bureau's sole discretion to put forth any consumer financial rule, law or guideline, and exempt whomever it wants. Sections 1012, 1022,

1023. The Bureau's interpretation of such rule, law or guideline shall be the only interpretation the courts take into consideration. Section 1022.

Covered Persons

Persons subject to the Bureau's enforcement authority ("covered persons") are persons who offer or provide consumer financial products or services, and the affiliates of such persons who are service providers. Section 1002. Examples of covered persons include banks, savings associations, credit unions, mortgage brokers, debt collectors, and consumer reporting agencies.

Excluded Persons and Activities

Specified groups of persons and activities are excluded from the Bureau's authority. The broadest group of excluded persons are persons who do not sell financial goods or services. Section 1027. Merchants who offer consumer credit for non-financial goods or services are also exempt, unless an exception applies (*e.g.*, a merchant regularly extends credit with a finance charge). Section 1027. Other exempt persons or activities include businesses that meet the small business threshold of the Small Business Act, auto dealers, real estate brokerage activities, manufactured and modular home retailers, accountants, tax preparers, persons engaged in the practice of law, persons subject to regulation by a state insurance regulator or the SEC, and employee benefit and compensation plans. Sections 1027, 1029. Additionally, insurance cannot be defined as a financial product or service. Section 1027.

Consumer Financial Laws and Functions Under the Bureau's Control

The goal is to have one, and only one, office in charge of protecting consumers. Thus, Section 1002 broadly defines the "Federal consumer financial laws" under the Bureau's control to include: (a) rules, orders and guidelines put forth by the Bureau; (b) all consumer financial protection functions, powers and duties transferred from the Federal Reserve Board, the OCC, the OTS, the FDIC, the Federal Trade Commission (FTC), the Federal Trade Commission Act (FTC Act), the National Credit Union Administration, and the Department of Housing and Urban Development; and (c) the "enumerated consumer laws" listed in Section 1002, which are the following:

- Alternative Mortgage Transaction Parity Act of 1982
- Consumer Leasing Act of 1976
- Electronic Fund Transfer Act
- Equal Credit Opportunity Act – except auto dealers, which remain in the FTC's control
- Expedited Funds Availability Act
- Fair Credit Billing Act
- Fair Credit Reporting Act, except with respect to Sections 615(e) and 628 of that Act
- Fair Debt Collection Practices Act
- Subsections (b) through (f) of Section 43 of FDIA
- Sections 502 through 509 of the Gramm-Leach-Bliley Act, except for Section 505 as it applies to Section 501(b)
- Home Mortgage Disclosure Act of 1975

- Home Ownership and Equity Protection Act of 1994
- Homeowners Protection Act of 1998
- Interstate Land Sales Full Disclosure Act
- Section 626 of the Omnibus Appropriations Act (2009)
- Real Estate Settlement Procedures Act of 1974
- Secure and Fair Enforcement (S.A.F.E.) for Mortgage Licensing Act of 2008
- Truth in Lending Act
- Truth in Savings Act

Powers of the Bureau

Examination Authority

In regards to examinations, the Bureau has the exclusive authority to and must periodically conduct compliance examinations of: (a) covered persons with over $10 billion of assets; (b) all businesses in the mortgage industry (mortgage brokers, lenders, servicers, and foreclosure scam operators); (c) all payday lenders; (d) all private education lenders; and (e) after notice and an opportunity to be heard, any person who offers or provides consumer financial products or services that the Bureau reasonably believes poses a risk to consumers. Sections 1024-25. Any entity that handles an integral part of the operation of these covered entities is also under the enforcement authority of the Bureau (such as a vendor that provides an institution's core processing system).

Any covered persons that are not listed above (such as institutions with less than $10 billion in assets) are subject to the enforcement authority of the prudential regulator. Section 1026. The Bureau may still participate in examinations or require reports from such institutions.

Authority to Mandate Registration

Outside of insured depository institutions, insured credit unions, or associated persons, the Bureau may require registration of any covered person. Section 1022.

Authority to Regulate Against Unfair, Deceptive, or Abusive Acts or Practices

The Bureau may use any of its enforcement powers to prohibit unfair, deceptive, or abusive acts or practices by any covered person when engaged in a consumer financial transaction. Section 1031. However, such enforcement authority is shared with FTC. Section 1061. Any unfair, deceptive, or abusive act or practice is subject to the civil penalties mandated by the FTC Act. Section 1100A.

Authority to Regulate Disclosures

The Bureau has the power to mandate specified disclosures for consumer financial products or services to enable consumers to understand the risks, benefits and costs of the product or service being purchased. Section 1032.

Authority to Hold Investigations and Hearings

In addition to examinations and rulemaking, the Bureau may engage in investigations, issue subpoenas and cease-and-desist orders, conduct hearings, and commence civil actions for violations of Federal consumer financial laws. Sections 1052-53.

Preemption

If a State's consumer financial law is inconsistent with Federal financial consumer law, all inconsistent components of the State law are preempted. However, the State law is not preempted where it is consistent with, but provides greater consumer protection than, the Federal law. Section 1041. State consumer financial laws may also be preempted: (a) if the State law would result in discrimination against national banks; (b) if it is so determined by the OCC that the state law thwarts or substantially interferes with the exercise of a national bank's powers; or (c) other Federal law preempts such State financial consumer law. Section 1044.

Penalties

If a covered person should violate Federal consumer financial law, there are nine avenues of relief: (1) rescission or reformation of the violators' contracts; (2) the violator must refund money and/or return real property; (3) restitution; (4) reimbursement for unjust enrichment; (5) payment of damages; (6) publicly accessible notice of the violation; (7) limited ability of the covered person to engage in some activities; (8) civil monetary penalties (up to $1 million per day); and (9) recovery of litigation costs by the Bureau. However, exemplary and punitive damages are not available remedies. Section 1055.

Risk Retention on Home Mortgage Loans

Unless a mortgage is deemed a "qualified residential mortgage" or an asset-backed security collateralized exclusively by "qualified residential mortgages," businesses that package residential mortgages into asset-backed securities must retain at a minimum five percent of the credit risk. Section 941. Accordingly, if the investment fails, the business that packaged and sold the mortgages shares some of the risk. That five percent of the credit risk cannot be hedged or otherwise reassigned to a third party. Such risk retention applies regardless of whether or not the subject lender is an insured depository institution. Further, issuers of such packaged mortgages are required to disclose additional information regarding the underlying assets and scrutinize the quality of the underlying assets.

Qualified Residential Mortgage Defined

Although the term "qualified residential mortgage" will be specifically defined by the Federal Reserve Board (although subject to change by the Bureau once it is up and running) through amendments to Regulation Z, the Act mandates that the definition not be more broad than Section 129C(b)(2) of the Truth in Lending Act—a new section added by this Act. Section 129C(b)(2) defines a "qualified residential mortgage" in two parts: (1) what is not a qualified residential mortgage, and (2) what is a qualified residential mortgage. Section 1412. A loan is not a qualified residential mortgage if it (i) includes payments that will result in an increase in the principal balance; (ii) allows the consumer to defer principal payments (with certain

exceptions), or (iii) includes a balloon payment that is greater than two times the average earlier scheduled payments (with certain limited exceptions). In order to be considered a qualified residential mortgage, the consumer's income must be verified, the payments must be fully amortizing (and the loan term cannot exceed 30 years), the total points and fees must be less than three percent of the total amount of the loan, and the loan must comply with any requirements adopted by the FRB under Regulation Z.

Mortgage Underwriting

Other sections were added to the Truth in Lending Act that impose new underwriting standards for residential mortgage loans that will be subject to the Bureau's authority and rulemaking. The new standards require lenders to establish a good faith and reasonable belief that the consumer will be able to pay back the loan based on verified and documented information – such as the consumer's debt-to-income ratio, current income, credit history, etc. Unless the loan is not a standard loan, the consumer's ability to pay must be based on a payment schedule that fully amortizes the loan over the course of the loan. The determination as to whether or not a consumer can repay a variable rate loan that requires or allows the consumer to defer the repayment of any principal or interest must be based on a fully amortizing repayment schedule. On the other hand, with an interest-only loan, the creditor must determine the consumer's capacity to repay based on the payment amount required to fully repay the loan by its maturity date. Section 1411.

If the lender fails to establish a good faith belief that the consumer has the ability to pay back the loan, the consumer may use such failure as a defense during a foreclosure proceeding, or as a means for recoupment, or as grounds for a counterclaim. Section 1413.

Safe Harbor

If the mortgage is a qualified residential mortgage, then the mortgage fits into a safe harbor and there is a rebuttable presumption that the consumer can pay back the loan. Section 1412.

Mortgage Reform and Anti-Predatory Lending Act.

In addition to the above underwriting standards, Title XIV of this Act gives the Bureau the authority to enforce and regulate residential mortgage loan origination standards, additional minimum standards for mortgages, and high-cost mortgages.

Origination Fees

The new regulations will prohibit a mortgage originator from basing its fees on the terms of the loan, except for the amount of the principal. Section 1403.

Prohibition of Steering Incentives

Steering incentives will be prohibited – such as steering to mortgages that the consumer cannot afford, steering to mortgages that have predatory characteristics, or steering away from a qualified mortgage to an unqualified mortgage. Section 1403.

Prohibition of Prepayment Penalties

Prepayment penalties are prohibited entirely for non-qualified mortgages. For purposes of including prepayment penalties, the definition of what is not a qualified mortgage is expanded (*e.g.*, a qualified mortgage does not include an adjustable rate mortgage or a loan with an APR that exceeds certain thresholds over the average prime offer if a loan is not a rate). Even if the mortgage is a qualified mortgage, prepayment penalties are limited based upon the length of time that has passed since the loan was consummated. Section 1414.

Additional Prohibitions

In addition to a prohibition against waivers of statutory causes of action, arbitration agreements are prohibited in residential mortgage loans and open-end lines of credit that are secured by the consumer's principal dwelling. Section 1414. Negative amortization mortgages are prohibited for both open- and closed-end credit that is secured by the consumer's principal dwelling unless certain prescribed disclosures are made to the consumer.

Additional Disclosures

If a residential mortgage loan is subject to a State's anti-deficiency law and a loss of the anti-deficiency law's protection would result from refinancing the loan, the creditor will have to advise the consumer of this fact. Section 1414. New disclosures will be required in connection with hybrid adjustable rate mortgages. The term "hybrid adjustable rate mortgage" means a consumer credit transaction secured by the consumer's principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period (for example, loan has a fixed rate for three years and then the rate adjusts annually thereafter).

With regard to the Truth in Lending disclosure statement given at consummation of a residential mortgage loan, new information will have to be disclosed, including settlement charges, mortgage originator fees and the total amount of interest due over the life of the loan. Section 1419. In addition for variable-rate residential mortgage loans for which an escrow or impound account will be established, the Truth in Lending disclosure statement will have to include the monthly payment amount (which must include the amount required to be escrowed) and the amount of the fully indexed payment due under the loan (again, including the amount required to be escrowed).

The Act also has amended the TILA to require creditors to provide periodic statements for residential mortgage loans. Section 1420. The periodic statements must disclose:

- The amount of principal due;
- The current interest rate;
- Any prepayment penalties;
- An explanation of any fees for a late payment;
- The lender's contact information; and
- Contact information for counseling agencies approved by HUD or a State housing authority.

High-Cost Mortgages

The Act has also amended the definition of a high-cost mortgage loan under the TILA to lower the thresholds, replace the use Treasury securities with the average prime offer rate in determining whether the applicable threshold has been exceeded and expand the definition of “points and fees” to include additional fees, such as credit insurance premiums payable at or before closing, all compensation paid to a mortgage origination and the maximum prepayment penalties which may be charged according to the terms of the loan. Section 1431.

High-cost mortgages cannot include balloon payments or acceleration clauses (with certain exceptions), late fees are limited to four percent of the amount of past due payment, full payments must be applied to the applicable period (not to late fees), a creditor may not advise the consumer to default on any existing debt refinanced by the high-cost mortgage, and, for the most part, payoff statement fees are prohibited. Sections 1432-1433.

Durbin Amendment (Interchange Fees)

Interchange fees on electronic debit transactions may now be regulated by the Federal Reserve Board and must be limited to an amount that is “reasonable and proportional to the cost incurred by the issuer.” Within this power to regulate is also the power of the FRB to require issuers to report at least biannually all charged and received interchange fees. Section 1075.

Issuers with less than $10 billion of assets, some prepaid cards for governmental programs, and some reloadable prepaid cards, are exempted from these interchange fee regulations. Section 1075. Those governmental programs’ prepaid cards include Federal, State, or local government-administered payment programs unless it is an overdraft fee or first withdrawal per month fee from an ATM within the issuer’s network. The reloadable prepaid cards exemption applies to prepaid cards that: (a) are loaded with the monetary value on a prepaid basis; (b) do not gain access to the cardholders’ account(s); (c) are usable at multiple ATMs or other providers; and (d) are not represented as gift certificates or gift cards.