

A Federal Analysis: Dodd-Frank, GSE Reform – Where Is It Headed?

A presentation by

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to the

Maine Bankers Association

at its

Summer Senior Management Conference

August 18, 2011

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- Credit unions have their problems, too
- Dealing with the challenges facing community banks today
- **The 2012 election outlook**

DFA's regulatory onslaught – the status of DFA regulation-writing

- **One law firm has identified 400 rules which regulators must write to implement DFA**
 - **Most rules targeted for adoption by year-end 2012**
 - **As of July 22, deadlines had already been missed for 130 rulemakings**
 - **More deadlines will be missed as the rulemaking continues well beyond 2012**

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- **Future changes in DFA will further complicate the rulemaking process**

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- **Rethinking how “systemically important financial institutions” (SIFIs) are dealt with**

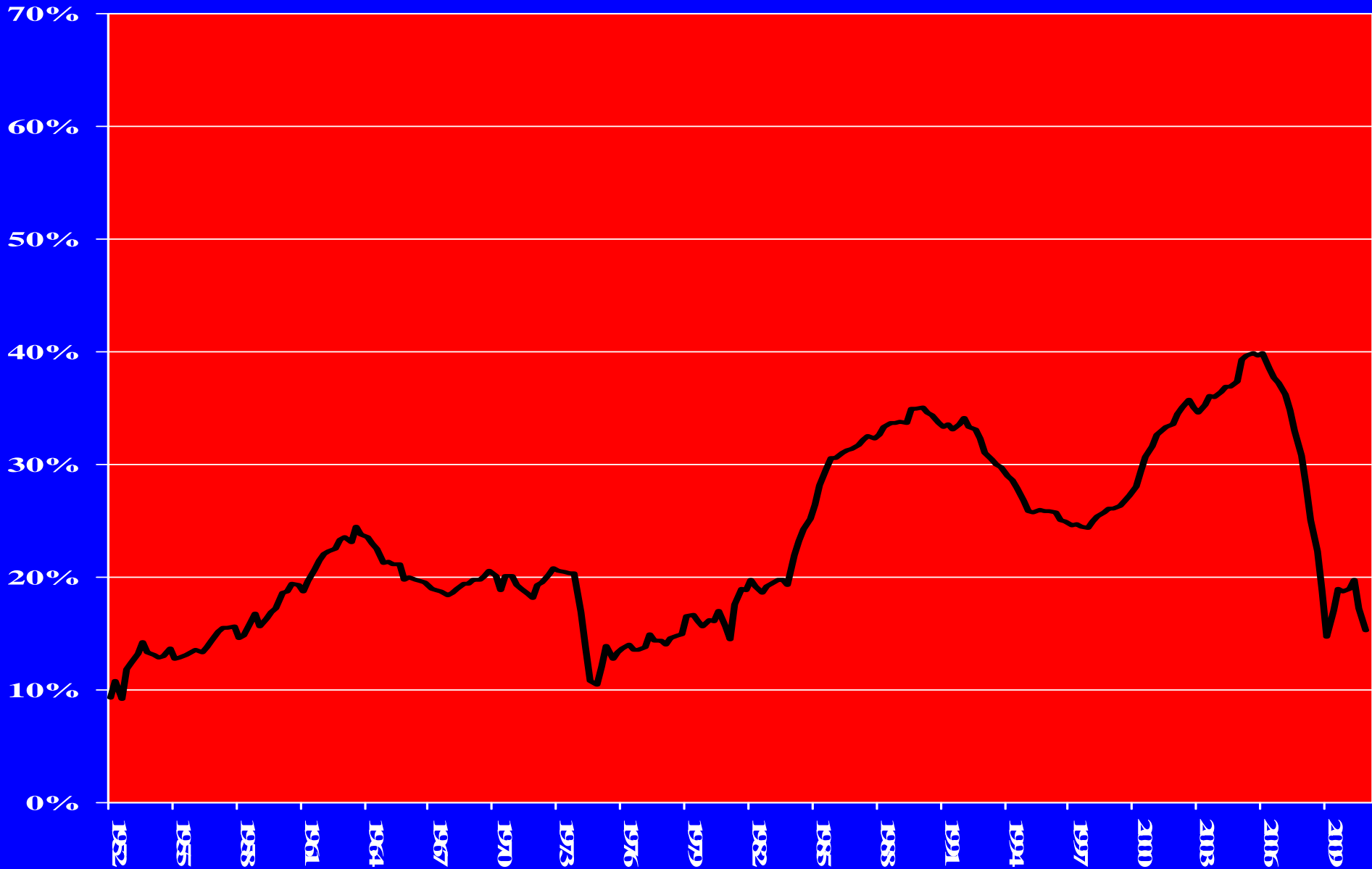
Cleaning up the mortgage mess

The scale of the housing-finance mess today

- **Nationally, the home-price decline has taken the air out of the underlying land bubble**

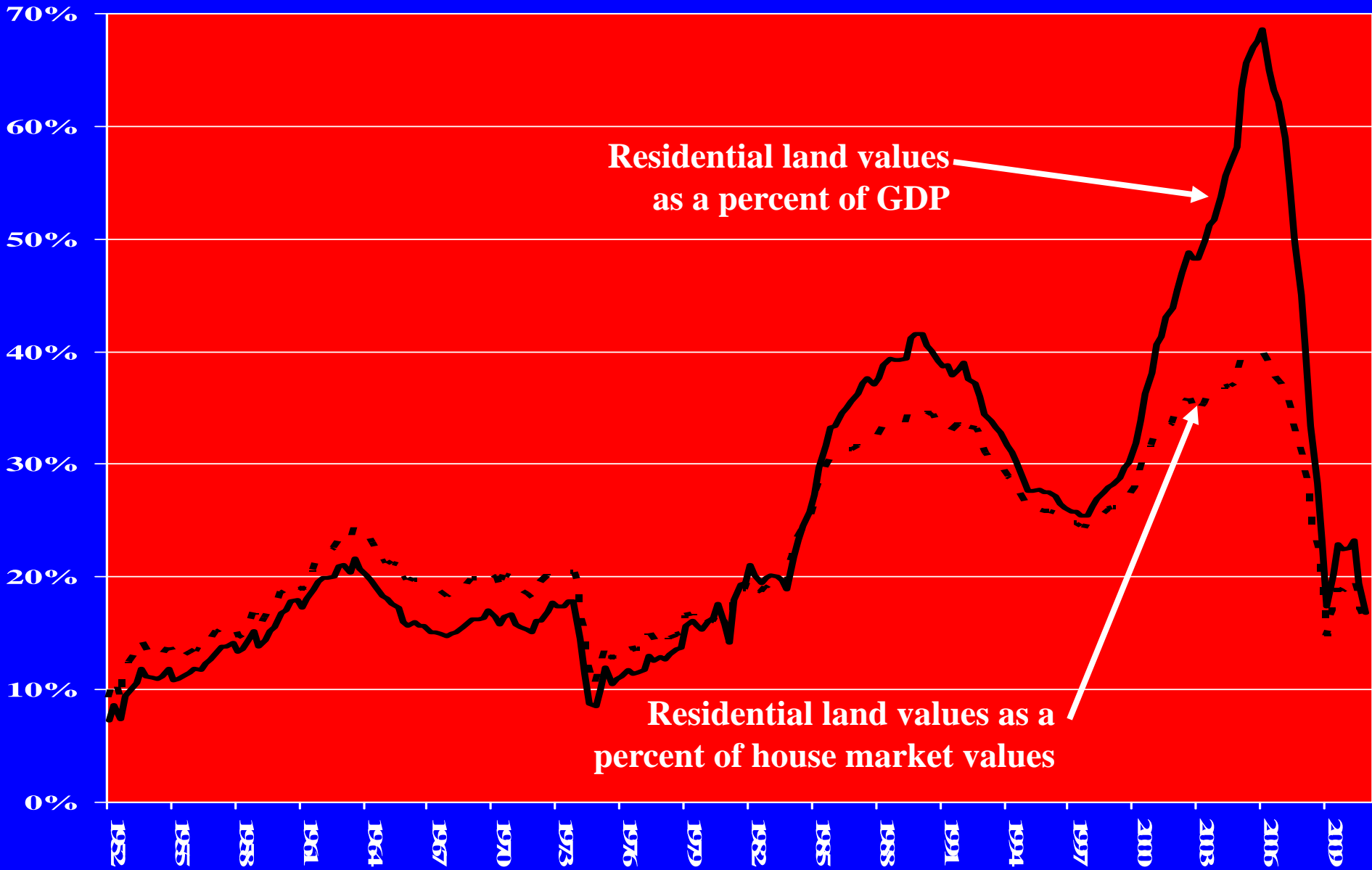
Market value of the land on which owner-occupied housing sits on as a percentage of the estimated market value of that housing

(Derived from Federal Reserve Flow of Funds data; 1952Q1 to 2011Q1)



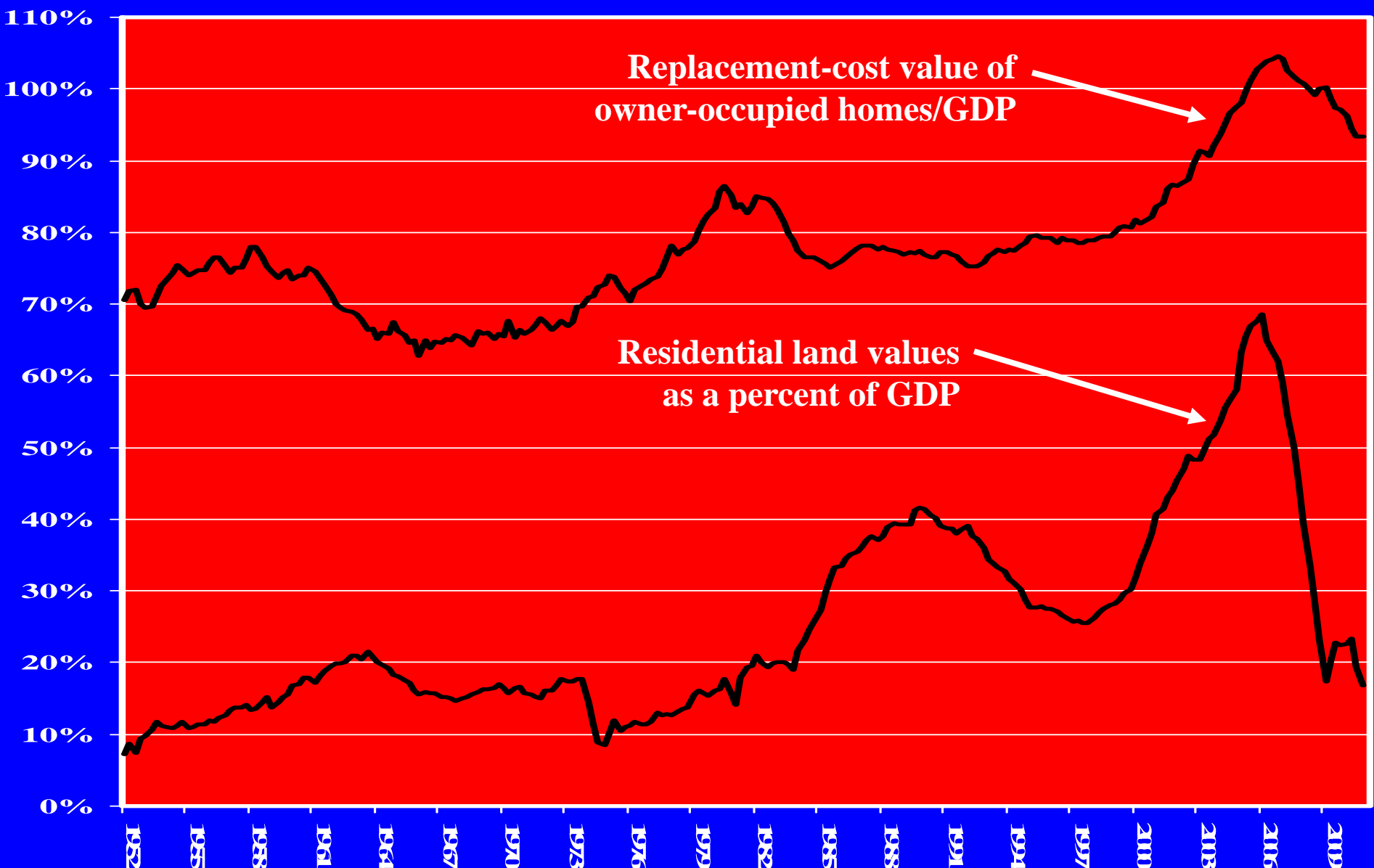
Market value of the land on which owner-occupied housing sits as (1) a percentage of GDP and (2) the estimated market value of that housing

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Replacement-cost value of owner-occupied homes as a percent of GDP and the market value of the land on which those homes sit as a percent of GDP

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- **Increased federalization of home-mortgage credit risk**

Today's challenges in housing-finance

- **Working through the default/foreclosure mess**

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- **Preserving the 30-year fixed-rate mortgage (FRM)**
 - **30-year FRMs not a big credit risk if the initial LTV % low enough**
 - **The real issue in funding FRMs is minimizing maturing mismatch – who holds the rate-risk hot potato in funding a 30-year FRM?**

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- **Adjusting to the new consumer-protection environment**
 - **Are we facing an overcorrection in consumer protections?**
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- **What should the present system evolve into?**
 - **Barney Frank: You can't replace something with nothing**
 - **Striking an appropriate balance between portfolio lending – the lender keeps the mortgage – and securitization**

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- **Preventing future housing-finance crises**

GSE reform – what does it entail?

- **GSE reform focuses primarily on Fannie and Freddie (F&F) – a \$4.9 trillion credit-risk challenge**
 - **Downsize their investment portfolios – now \$1 trillion**
 - **Steadily lower the conforming loan limit**
 - **Dropping from \$729,750 to \$625,500 on October 1**

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 - **Limit FHLB funding for large banks?**
 - **Shrink or expand the scope of eligible FHLB collateral?**
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- **What should be the future role for FHA in housing finance?**

Other housing-finance reforms

- **Covered bonds (CBs) – well-tested in Europe**

Balance sheet of a covered-bond issuer with FDIC-insured deposits

Assets

=

Liabilities + Capital

Cover pool assets
(1xx% of covered
Bonds outstanding)

Assets securing
other borrowings, with
overcollateralization

Loans, other
types of assets
not securing
any liabilities

Covered bonds
outstanding (secured by
assets in the cover pool)

Other secured
borrowings – FHLB
advances, repos, etc.

Domestic deposits
(insured + uninsured)
with a liquidation preference
over other unsecured liabilities

Other unsecured
liabilities

Equity capital

Insolvency loss ↑

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- Consumer protections – the role of the CFPB
- **Reviving securitization**
 - **Risk-retention rules – what will qualify as a QRM?**
 - **“Premium capture” – a securitization killer?**

The future role of community banks in housing finance

- **All must recognize that DFA is a major threat to community banks, due to compliance burdens**
 - **Risk-retention rules (QRM) when selling mortgages could be problematic for community banks**
 - **Forthcoming CFPB mortgage rules may discourage community banks from mortgage origination**
 - **Effect of a premium-capture rule on selling mortgages?**
 - **National servicing standards could hurt small servicers**

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- Absent CB financing or FHLB advances, community banks cannot safely hold 30-year FRMs
- **ARMs and short-term FRMs may be the key to community banks staying in housing finance**

Current conditions in the banking industry

- **Banking industry earnings have increased for seven consecutive quarters, year over year**
 - **Q1 2011 earnings the best since Q2 2007**
 - **56% of banks reported higher earnings in the first quarter**
 - **Lower loan-loss provision key to higher earnings**

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- **Bank profitability will continue to benefit from declining loss provisions but will be hobbled by weak revenue growth**

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- FDIC has suffered \$83 billion of losses in this cycle
 - FDIC estimates \$110 billion of losses for 2008-2014
 - At December 31, the FDIC had a \$18 billion loss reserve
- **FDIC premiums will continue at a high level over the next three to five years as the DIF balance rebuilds to a minimum of 1.35% of insured deposits**

Credit unions have their problems, too

- **Credit unions are suffering from failures, too, causing large share-insurance premiums**
 - **CUs face heavy share-insurance premium assessments over the next few years due to huge securities losses in the corporate CUs**
 - **The NCUA may be burying weak and failing CUs in stronger CUs, thereby weakening the surviving CUs**

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 - Critically important to open the door to CU conversions to banks
- **A presidential commission has suggested taxing CUs, which would go a long way towards ending the CUs' unfair competitive advantage over banks**

Dealing with the challenges facing community banks today

- **Complying with new and revised regulations a huge challenge for the next few years**
 - **Dealing with delayed rulemaking an additional challenge**
 - **Adapting to new regulations a big challenge for examiners, too**

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 - **Continued low interest environment**
 - **Threats to fee income**

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- **Continuing consolidation within banking**

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- **Financial services issues potentially factoring into the 2012 elections – interchange fees, mortgage problems, fallout from the S&P downgrade**

Thank you

**I welcome your
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