

# Regulatory Update - The Dodd-Frank Wall Street Reform and Consumer Protection Act

Maine Bankers Association  
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# Dodd-Frank Wall Street Reform Act and Consumer Protection Act - Overview

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- Effective Dates of Implementation: From 1 day after enactment (July 22, 2010) to 5 years, most in 12 to 18 month range
- Regulatory Consolidation: 12-18 months, most expect mid-summer 2011
- Establishes 13 new regulatory and advisory agencies, offices and bureaus
- Requires 35 “studies” by regulators and GAO - will likely result in further rulemaking
- All financial institutions will be affected, larger institutions (\$50B+) more so

# Dodd-Frank Wall Street Reform Act and Consumer Protection Act - Overview

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- Many non-banks, mortgage companies and other financial service providers will now become “regulated”
- Dodd-Frank only a “skeleton” of reforms – real impact will be felt after new rules are issued, dozens of mandates and discretionary authority to write new rules, most new rules to come in next 6 months to 3 years
- Likely will not change how or where community banks do business but will increase costs of lending and deposit taking, increase compliance measures and require higher levels of capital

# Dodd-Frank Wall Street Reform Act and Consumer Protection Act - Overview

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1. New agency to enact/enforce new consumer protection laws
2. Federal regulatory consolidation, reduced charter choice
3. Systemic risk regulation for larger entities and non-banks
4. Increased regulatory capital requirements
5. Retention of risk for asset securitizations
6. Increased scrutiny on executive compensation
7. Regulation over derivatives market and “non-banks”
8. Increased regulatory, dissolution and resolution power
9. Increased investor protections
10. Oversight of credit rating agencies
11. Reduced federal preemption

# Dodd-Frank Wall Street Reform Act and Consumer Protection Act

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## Regulatory Restructuring

- OTS eliminated – effective one year after enactment, subject to a six month extension - federal thrift charter and savings and loan holding companies (SLHCs) retained
- All functions of OTS relating to federal savings associations, and all rulemaking authority for federal and state savings associations, transferred to Office of the Comptroller of the Currency (OCC)
  - New deputy comptroller for savings associations
- All functions of OTS – other than rulemaking – with respect to state savings associations transferred to FDIC
- All supervisory and rulemaking functions of OTS with respect to SLHCs transferred to Federal Reserve Board (FRB)

# Dodd-Frank Wall Street Reform Act

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## Regulatory Restructuring

- All actions, orders, regulations, interpretations and rulemakings of OTS continue until/unless superseded
- On or before the effective date of the elimination of the OTS, the FRB, OCC and FDIC shall identify and publish OTS regulations to be continued

# Dodd-Frank Wall Street Reform Act

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## Regulatory Restructuring Possible Effect on Mutuals and MHCs

- OTS responsible for major mutual bank and MHC developments (conversions, MHC mergers, second steps, use of stock funded foundation)
- OTS regulations are basis for most state mutual and MHC regulations, OTS precedent provides interpretive guidance for states and FRB/FDIC
- FRB has no regulations on MHCs or MHC second steps, effectively applies OTS regulations

# Dodd-Frank Wall Street Reform Act

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## Regulatory Restructuring Possible Effect on Mutuals and MHCs

- FDIC has limited regulations, effectively applies OTS regulations to state bank conversions
- OCC, FDIC, FRB will have the opportunity to rewrite conversion and MHC rules, every previous rewrite has been adverse and has reduced compensation plans and led to questions about depositor ownership rights
- State mutual banks and MHCs will be affected just like federal mutuals and MHCs

# Dodd-Frank Wall Street Reform Act

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## Holding Company Regulation

- Depository institution holding companies (BHCs and SLHCs) are to be subject to leverage and risk based capital requirements that are not less than nor quantitatively lower than those generally applicable to depository institutions
  - Trust preferred securities (TPS) no longer included as Tier 1 capital; BHCs and SLHCs with <\$15B in assets at 12/31 2009 grandfathered; for others a phase-out beginning January 1, 2013
  - Small BHC (<\$500 million assets) exemption will still apply
  - Capital requirements with respect to SLHCs shall not be effective for 5 years
- FRB shall require publicly traded BHCs >\$10B in assets, and may require publicly traded BHCs <\$10B in assets, to have a risk committee of independent board members with one member who is an expert in risk management

# Dodd-Frank Wall Street Reform Act

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## Holding Company Regulation

- All BHCs and SLHCs >\$10B in assets must conduct annual stress tests and report results to the FRB and its primary federal regulatory authority
- FDIC granted back-up examination and enforcement authority with respect to all depository institution holding companies, but not as to a holding company “that is generally in sound condition and whose conduct does not pose a foreseeable and material risk of loss to the DIF”
- To qualify as “financial holding company” a SLHC must satisfy all criteria applicable to a BHC
- FRB shall examine non-depository subsidiaries of holding companies, other than functionally regulated subsidiaries and subsidiaries of the depository institution, in same manner and to same extent as if activity conducted by depository institution
  - If FRB does not examine subsidiary, the appropriate federal banking agency may conduct an examination of the holding company subsidiary

# Dodd-Frank Wall Street Reform Act

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## Holding Company Regulation

- FRB shall seek to make capital requirements for BHCs and SLHCs counter-cyclical, *i.e.*, higher when economy expanding and lower in times of economic stress
  
- New Penalties For Failing QTL Test - failure will result in immediate restrictions and possible enforcement action rather than just requiring the thrift to become a bank within 12 months or becoming subject to certain asset growth restrictions
  
- QTL failure imposes limitation on dividends to holding company, dividends may only be paid if: 1) amounts would be payable by a national bank, 2) dividend is necessary for holding company to pay its obligations, and 3) if approved by the OCC and FRB
  
- Effect of any new QTL failure penalties and restrictions on "Section 10L holding companies" (SLHCs with state bank chartered subsidiaries) is somewhat unclear

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## Deposit Insurance Reform

- FDIC insurance premiums to be based on total assets (less tangible equity) rather than deposits
  
- Minimum reserve ratio for DIF increased from 1.15% to 1.35% of insured deposits, to be achieved by 2020
  - FDIC directed to offset the effects of increased assessments on depository institutions with <\$10B in assets
  
- Insured amount per depositor increased permanently to \$250K
  
- Unlimited insurance coverage for non-interest bearing transaction accounts maintained for two additional years

# Dodd-Frank Wall Street Reform Act

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## Deposit Insurance Reform

- The prohibition on paying interest on business checking is eliminated, effective one year after enactment
- Director of Consumer Financial Protection Bureau replaces OTS on FDIC Board

## Miscellaneous

- Any savings association that converts to a bank may continue any branch maintained at time of conversion and open new branches in state to same extent as bank chartered in such state
- National and state banks can branch *de novo* if under laws of state where branch to be located, a state bank chartered in such state can open branch

# Dodd-Frank Wall Street Reform Act

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## Miscellaneous

- State to federal charter (and federal to state) charter conversions are prohibited if enforcement action regarding a significant supervisory matter is pending, subject to detailed exception
- Requires regulators to establish “activity-based” capital requirements to address risks like significant volumes in derivatives, purchase and sale of securitized products, issuance of financial guarantees, repurchase agreements, concentrations of assets

# Dodd-Frank Wall Street Reform Act

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## SEC Reforms

- Investor Advisory Committee established and includes a representative of state securities commissions and 10-20 members appointed by the SEC to represent the interests of senior citizens, individual equity and debt investors and institutional investors (including pension funds), as well as the new “Investor Advocate”
  - purpose is to advise and consult with and make recommendation to SEC regarding regulatory priorities, the effectiveness of disclosures, and initiatives to protect investor interests and the integrity of the securities marketplace
  - SEC not required to act on findings or recommendations, but must publicly address them
  
- Office of Investors Advocate created to assist retail investors
  
- SEC to study the effectiveness of existing standards of care for brokers, dealers, investment advisors and their associated persons with respect to advice provided to retail customers
  - SEC authorized to establish standards of care and to prohibit mandatory arbitration agreements between brokers and their clients

# Dodd-Frank Wall Street Reform Act

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## Asset Backed Securitizations Reforms

- Regulatory agencies (SEC, OCC, FRB, FDIC; FHFA and HUD) are required to jointly issue regulations, within 270 days of enactment, requiring a loan/asset “securitizer” to retain (without hedging) a specified percentage of the credit risk
  - The % to be retained shall not be less than 5%, unless all assets are “qualified residential mortgages” (which would not require risk retention)
  - The % can be less than 5% if all loans are originated in compliance with underwriting standards approved by the OCC, FRB and FDIC
  - The regulations to provide for allocation of retained risk between securitizer and entity that created the securitized asset
  
- The regulations can exempt in whole or in part securitizations of assets issued by U.S. government or agencies (other than Fannie Mae or Freddie Mac) or any state or local government
  
- A “securitizer” is an issuer of asset backed securities (ABS) or a person who organizes and initiates an ABS transaction by selling or transferring assets to the issuer

# Dodd-Frank Wall Street Reform Act

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## SOX Amendments

- Small public companies (< \$75 million in market capitalization) exempted from 404(b) auditor attestation requirement with respect to management's report on internal controls over financial reporting
- PCAOB required to adopt independence standards for auditors, in addition to existing standards
- Brokers and dealers required to be audited in accordance with PCAOB standards by a PCAOB member firm
- Requires study of burden of 404(b) on issuers with a market capitalization between \$75 million and \$250 million

# Consumer Financial Protection Act of 2010

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- Independent Bureau of Consumer Financial Protection (Bureau) established within the FRB. Director appointed by President and confirmed by Senate and reports directly to the President. Five year term. Bureau funded through earnings of Federal Reserve System
- Transfers consumer protection powers of OCC, OTS, FDIC, FRB, FTC and HUD to Bureau. Transfer Date: no earlier than 180 days or more than 1 year
- The Bureau has jurisdiction over consumer financial products and services
- The Bureau may prohibit or impose conditions to prevent unfair, deceptive and abusive practices in connection with a consumer financial product or service, including prohibiting or limiting the use of binding arbitration agreements

# Consumer Financial Protection Act of 2010

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- The Bureau may adopt disclosures rules to ensure full, accurate and effective disclosure to enable consumers to understand the costs, benefits and risks associated with the product or service
- Must consult with other regulators prior to proposing rules and publish objections to proposed rules
- The Financial Stability Oversight Council (Council) may set aside a Bureau regulation upon a 2/3 vote
- The Bureau must adopt procedures for responding to consumer complaints

# Consumer Financial Protection Act of 2010

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- A consumer product or service is one offered or provided for use by consumer primarily for personal, family or household purposes
- A consumer is an individual or an agent, trustee or representative acting on behalf of an individual
- Bureau has broad investigative and enforcement authority with respect to most existing consumer laws and any new regulations adopted, including with respect to depository institutions >\$10B in assets
  - Enforcement authority with respect to insured depository institutions with <\$10B in assets remains with the appropriate federal banking agency, but the Bureau can require reports from institution, refer suspected violations to the agencies and have Bureau examiners included in agency examinations

# Consumer Financial Protection Act of 2010

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- State attorneys general may enforce the statutory requirements in federal or state courts, but can only enforce Bureau regulations, not the statute, against national banks and federal thrifts. The attorneys general must first consult with the Bureau before bringing an action
- Federal preemption of state consumer laws is scaled back and does not apply to subsidiaries of national banks or federal thrifts
- No authority over: 1) sellers of non-financial goods that supply financing for such goods, 2) merchants/retailers not engaged significantly in offering consumer financial products or services, 3) insurance companies, 4) most auto dealers, 5) real estate brokers, 6) small businesses, manufactured and mobile home retailers, 7) entities regulated by the SEC, CFTC, or Farm Credit Admin

# Mortgage Reform and Anti-Predatory Lending Act

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- Creditors proscribed from making residential mortgage loans without having made a reasonable, good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan in accordance with its terms (based upon a fully amortized loan)
  - A safe harbor for a “qualified mortgage loan” as defined
- Mortgage originators cannot be paid compensation that varies based on the terms of the mortgage (other than the amount)
- Consumers can assert violations of the foregoing and penalties therefore as a defense or set off to foreclosure actions

# Mortgage Reform and Anti-Predatory Lending Act

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- Mortgage originators cannot receive from any person other than the consumer (and no person other than the consumer who knows or should know that a consumer has or will compensate a mortgage originator may pay to a mortgage originator), any origination fee or charge other than bona fide third party charges not retained by the creditor, mortgage originator or affiliates
- New restrictions, limitations and regulations regarding: prepayment penalties for residential mortgage loans; negative amortization loans; and “high cost” mortgage loans
- Mixed authority to regulate between FRB and Bureau

# Dodd-Frank Wall Street Reform Act

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- Financial Stability Oversight Council created upon enactment of Act, with voting members consisting of the Treasury Secretary (Chair), the Chairpersons of the FRB, SEC, FDIC, CFTC and the NUA; the Comptroller of the Currency; the directors of the FHFA and the Bureau; and one member appointed by the President with consent of Senate having insurance expertise. Also five nonvoting members consisting of the director of the newly established Federal Insurance Office (FIO) and the Office of Federal Research (OFR) and representatives
- The council can make recommendations to the FRB and other federal banking agencies for stricter prudential standards and reporting and disclosure requirements with respect to companies that pose a threat to the financial stability of the US, which generally are bank holding companies with assets >\$50B and non-bank financial companies that are predominantly engaged in financial activities (“systemically significant” companies)

# Dodd-Frank Wall Street Reform Act

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- The OFR supports the Council by collecting data and performing research and has subpoena authority
- The FIO is established within the Department of the Treasury and is tasked with monitoring all aspects of the insurance industry, recommending to the Council that it designate an insurer as systemically significant and coordinating federal efforts regarding international insurance matters
- The FDIC is given new authority to address the failure of systemically significant companies, in order to allow for the orderly liquidation of such companies in coordination with existing bankruptcy laws

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Say on Pay

- Proxy statements issued more than six months following enactment that include compensation disclosure under the SEC's proxy disclosure rules must include a non-binding shareholder proposal to approve the compensation of executive officers
- Shareholders must also vote to determine whether the say on pay proposal is voted upon every one, two or three years (which vote must occur at least once every six years)

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Shareholder Disclosure and Vote on Golden Parachute Payments

- Proxy statements issued more than six months following enactment that solicit shareholder approval of an acquisition, merger, sale or disposition of assets or similar matters must include disclosures in “clear and simple terms” of all payments to NEOs that are based on or related to the transaction and the proxy statement must include a nonbinding proposal enabling shareholders to vote to approve the golden parachute payments, unless the arrangements have previously been subject to a say on pay vote

## Fiduciary Duties of the Board

- Neither the Say on Pay nor the Golden Parachute votes are intended to create or imply any change to the fiduciary duties of such issuer or board of directors or to create or imply any additional fiduciary duties for such issuer or board of directors

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Compensation Committee

- Publicly traded companies are required to have a compensation committee consisting entirely of “independent” directors
  - Independence standards may be similar to those for audit committee members
- The compensation committee must have the authority to hire independent advisors and may only engage a compensation consultant, legal counsel, or other adviser after taking into consideration the independence of such persons in accordance with standards adopted by the SEC
- The advisors or consultants must report directly to the committee
- The annual meeting proxy statement must disclose whether the committee engaged a compensation consultant, and whether the engagement raised any conflicts of interest issues

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Broker Voting Restrictions

- The rules of a national securities exchange (NYSE; Nasdaq) must prohibit members – brokers – from voting shares with respect to the election of directors, executive compensation or any other “significant matter,” as determined by the SEC, unless the broker receives the voting instructions of the beneficial owner of the shares
- NYSE Rule 452, implemented in 2010, prohibits broker voting in the election of directors

## Executive Compensation Disclosure

- Proxy statements must include a clear description of executive compensation, including the relationship between compensation paid and financial performance of the Company, pursuant to rules to be adopted by the SEC

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Equity Pay Disclosure

- SEC must amend the executive compensation disclosure rules to require annual meeting proxy disclosure of (i) the median of the annual compensation of all employees, excluding the compensation of the CEO, (ii) CEO compensation, and (iii) the ratio of median employee compensation to CEO compensation (the total compensation column of the S-K Item 402 Summary Compensation Table)

## Claw-Back Policy

- Publicly traded issuers will be required to implement and disclose its “clawback” policy: in the event that the issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer who received incentive-based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Bank Compensation Standards

- Within 180 days of enactment, the FRB, in consultation with the OCC and the FDIC, is required to issue rules prohibiting unsafe and unsound compensation practices by BHCs

## Hedging Policy Disclosure

- Proxy statement disclosure required as to an issuer's "hedging policy", *i.e.*, whether employees or directors are permitted to purchase financial instruments designed to hedge or offset decreases in the market value of equity securities of the issuer held granted to employees or directors

## Chairman of the Board/CEO

- SEC must adopt rules requiring disclosure in proxy statements as to why the issuer has determined to combine or not combine the roles of the CEO and Chairman of the Board

# Corporate Governance Under the Dodd-Frank Wall Street Reform Act

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## Proxy Access

- The SEC expressly authorized to adopt proxy access rules
- Relates to shareholders' ability to nominate individuals for election to board through the company's proxy material
  - Only board nominees currently are included in management proxy statement; to nominate and elect a director, shareholder has to engage in a proxy contest and solicit proxies, which is time consuming and expensive

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