



Dodd-Frank Wall Street Reform and Consumer Protection Act: Key Issues for Savings Associations

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- **Regulatory Restructuring** - Dodd-Frank Wall Street Reform and Consumer Protection Act (Act) contains a substantial restructuring of the federal regulation of savings associations
- **Office of Thrift Supervision** - Office of Thrift Supervision (OTS) eliminated
- **Office of the Comptroller of the Currency** - Regulation, supervision and examination of Federal savings associations (FSAs) transferred to the Office of the Comptroller of the Currency (OCC)
- **Deputy Comptroller** - Creation of Deputy Comptroller position at the OCC for savings associations

- **State Associations** - Examination and supervision of state savings associations transferred to Federal Deposit Insurance Corporation (FDIC)
- **Rulemaking** - OCC given rulemaking authority over all savings associations, federal and state
- **State Banks** - State chartered commercial and savings banks continue with the FDIC, or the Federal Reserve Board (FRB) if Fed Member

S&L Holding Companies

FRB takes over from OTS as the federal regulator for all savings and loan holding companies and their non-depository subsidiaries

- Includes supervision, examination and enforcement authority over S&L holding companies and non-depository subs
- FRB also given rulemaking authority for affiliate transactions, insider lending and anti-tying restrictions as to savings associations and savings and loan holding companies

Consumer Agency

Consumer Financial Protection Bureau (CFPB) established as an independent bureau of FRB to assume responsibility for consumer protection and fair lending laws

- CFPB will be headed by a director appointed by President for five year term and confirmed by Senate (Treasury Secretary may perform duties of director until a director is appointed and confirmed)
- CFPB director will join FDIC Board of Directors in place of OTS Director
- CFPB to be a bureau of and funded by FRB but Act contains safeguards to assure CFPB's independence from FRB

Consumer Agency

- Along with taking over federal financial consumer protection and fair lending laws (e.g. Truth in Lending, RESPA, Equal Credit Opportunity), CFPB will have authority to issue regulations preventing “unfair, deceptive or abusive acts or practices,” require increased expanded disclosures for financial products and respond to consumer complaints
- Community Reinvestment Act does not transfer to CFPB

Consumer Agency

- Authority to examine depository institutions of over \$10 billion in assets, non-bank mortgage-related businesses such as mortgage brokers and servicers and certain other providers of financial products or services
- Depository institutions of \$10 billion or less assets will continue to be examined for compliance by the applicable federal depository institution regulators, except that the CFPB can participate in examinations on a “sampling basis”

- **Timing** - Transfer of OTS' regulatory functions within one year of enactment, subject to a possible six month extension (the "Transfer Date")
- **Regulations** - Existing OTS regulations transferred to the appropriate successor agency (OCC or FRB)
- **Employees** - Existing OTS employees transferred to a position with same status, tenure and at least the same pay at either the OCC or FDIC
 - Former OTS employees protected from involuntary separation (except for cause), reassignment or pay reduction for 30 months from transfer

- **Property** - No later than 90 days after the Transfer Date, OCC and FDIC assume the real and personal property of OTS
- **OTS Funds** - Any excess funds of the OTS apportioned to the OCC, FDIC and FRB
- **Dissolution of OTS** - OTS ceases to exist 90 days after the Transfer Date
- **Transfer to CFPB** - Transfer to the CFPB comes on a date designated by the Secretary of the Treasury; between 180 days and 12 months of enactment (subject to a possible additional six month extension)

- **Preemption** - Law governing federal preemption with respect to federal savings associations (and national banks) narrowed by Act
- **OTS Authority** - Previously, very broad authority of OTS to preempt state law
 - o Upheld by Supreme Court's De La Cuesta decision in 1982
 - o OTS generally preempted all state laws as to FSA operations except basic contract, tort, property and criminal laws

- **Standards** - Three circumstances under which a state consumer financial law will now be preempted as to operations of FSA (or national bank)
 - o Discriminatory effect
 - o “Prevents or Significantly Interferes” with exercise of authorized powers based on substantial evidence in record
 - o Preempted by a federal law other than the Act

- **OCC Determinations** - OCC may, on a case-by-case basis, determine whether state consumer financial laws are preempted as to FSAs (and national banks), but must consult with the CFPB under certain circumstances
 - OCC preemption decisions subject to a less deferential standard of judicial review
- **Subsidiaries** - Act says that state consumer laws are generally not preempted as to non-depository subsidiaries and affiliates
- **State Enforcement** - State attorneys general (but not state regulators) may enforce applicable consumer protection laws (including CFPB regulations and non-preempted state laws) through court actions

Federal Charter

FSA charter left fully intact

- Existing FSAs preserved and new federal charters may be issued
- Obama Administration's original legislative proposal required FSAs to become banks within a year of enactment
- Senate Banking Committee bill terminated the FSA charter but grandfathered existing FSAs

Federal Charter

Preservation of FSA Charter: A Pyrrhic Victory?

- Elimination of separate thrift regulator
- Curtailment of federal preemption
- Expansion of commercial bank branching
- Survival of FSA Charter Long-Term
- Effective strategic planning requires periodic evaluation of charter

- **FDIC Assessments** - FDIC required to base its deposit insurance assessments on average total assets less tangible equity rather than deposits
- **Deposit Insurance Limits** - \$250,000 deposit insurance limit made permanent
- **Non-interest bearing Transaction Accounts** - Transaction Account Guarantee Program extended until 2012
- **Deposit Insurance Fund Ratio** - Minimum target Deposit Insurance Fund ratio changed to 1.35% of the estimated amount of insured deposits by September 30, 2020 (compared with current 1.15%)
 - o Institutions with assets of \$10 billion or more will pay increased premiums to bring the ratio from 1.15% to 1.35%
 - o Existing maximum ratio of 1.50% eliminated

- **Charter Conversions** - No conversions if enforcement action outstanding including MOU
 - Exception if existing and prospective federal and state regulators accept corrective plan and allow conversion
- **Branching** - Savings association that converts to a bank may retain existing branches
 - New branches may be established or acquired to the extent permitted banks chartered by that state
- **Qualified Thrift Lender Test** - Consequences of noncompliance with QTL test amended to include enforcement actions for violations of law
- **Business Demand Deposits** - Depository institutions authorized to pay interest on commercial demand deposits effective one year from enactment

Holding Company Capital/Collins Amendment

FRB required to establish consolidated leverage and risk-based capital requirements for depository institution holding companies

- Quantitative requirements and components of capital must be as stringent as for insured depository institutions
- Requires that consolidated capital requirements be imposed on all savings and loan holding companies
- Eliminates instruments such as cumulative preferred stock and trust preferred securities from tier 1 capital since non-includable at depository institution level

- **Transition Rules/Exemptions** - Collins Amendment in Senate contained neither grandfather of existing issuances nor a transition schedule
 - o Conference Committee added grandfather/transition rules
 - o Delayed implementation period of five years as to any holding company not subject to FRB supervision as of May 19, 2010, i.e., savings and loan holding companies, except that instruments issued after May 19, 2010 will not be grandfathered when requirements apply
 - o Instruments issued by May 19, 2010 grandfathered for holding companies of less than \$15 billion in total assets (as of December 31, 2009) and mutual holding companies in existence on May 19, 2010

- o TARP cumulative preferred stock issued prior to October 4, 2010 exempted so can remain tier 1
- o Exemption for any small bank holding company subject to the FRB's Small Bank Holding Company Guidelines, as in effect on May 19, 2010
- **Countercyclical Capital Requirements** - Bank and holding company regulators required to “seek” to make regulatory capital requirements countercyclical consistent with safety and soundness
 - o “Countercyclical” means that capital required increases in times of economic expansion and decreases in times of economic contraction

Source of Strength

FRB's "source of strength" doctrine codified and applied to bank and savings and loan holding companies

- Requires holding company to provide financial assistance to the subsidiary institution in times of financial distress
- FRB to issue regulations to implement source of strength doctrine

Risk Retention

Contains “skin in the game” requirement so that a “securitizer” must retain a portion of credit risk transferred

- “Securitizer” includes issuers of asset-backed securities and originators who transfer loans to issuer
- Risk retention to be allocated between securitizer and originator
- General retention requirement of at least 5% of the credit risk transferred

Risk Retention

- No hedging or transferring the retained risk
- Exceptions for “qualified residential mortgage assets,” and low risk loans in various asset classes, as specified by regulators
- Forthcoming regulations must specify permissible forms of risk retention and the duration and allocation of risk sharing between originators and securitizers

Mortgage Reform

Mortgage reforms intended to correct perceived abuses

Yield Spread Premiums - Yield spread premiums banned

- Compensation to mortgage originator that varies based on the terms of the loan (other than the principal amount) prohibited

Steering - Regulations required to prohibit originators from engaging in certain steering practices or other activity deemed abusive

- Prohibited activities include steering customers to loans that they lack a reasonable capacity to repay or that contain predatory characteristics (e.g., excessive fees, abusive terms)

Mortgage Reform

- **Repayment** - Regulations also required to prohibit the making of residential mortgage loans unless a good faith determination is made by lender, based on verified and documented underwriting information, that borrower has a reasonable ability to repay
 - o Presumption that borrower has a reasonable ability to repay “qualified mortgages” as defined in regulations
- **Appraisals** - Lenders must obtain appraisals meeting specified requirements before making “higher risk mortgages”
- **HOEPA** - Expanded coverage and enhanced disclosures and protections required for certain high cost mortgages

- **Derivatives** - Act requires that derivatives trading be “pushed out” of insured depository institutions
 - o Exceptions to hedge risk from own activities and activities related to rates or assets that are permissible for national bank investment
- **Volcker Rule** - Regulators required to restrict depository institutions, holding companies and their affiliates from proprietary trading or investing in or sponsoring hedge funds and private equity funds
 - o “Proprietary Trading” is engaging as principal in purchase or sales of securities or derivatives for purposes of profiting from short-term price movements

- **Swipe Fees** - “Durbin Amendment” requires the establishment of standards for interchange transaction fees for debit cards according to the “reasonable and proportional cost” for each transaction
 - o Exemption for small issuers under \$10 billion in total assets

Compensation and Governance Provisions

“Say on Pay”

- All public companies must give shareholders a non-binding vote to approve executive compensation beginning with first annual meeting six months after enactment
- At least once every six years, shareholders must be given the opportunity to vote on how often they want “Say on Pay” vote - every one, two or three years

Golden Parachute Compensation

- Proxy solicitation material for a business combination must clearly describe compensation to be paid to named executive officers as a result of the transaction - and provide total number
- Golden parachute compensation must be subject to a non-binding shareholder vote at the time the transaction is approved unless previously approved under a “say on pay” vote

Compensation Committee Independence

- Listed companies must have a compensation committee that meet independence requirements similar to those for audit committees under the Sarbanes-Oxley Act
- Directors who receive consulting, advisory or other compensatory fees or who are affiliates of the company will not be independent

Compensation Consultants

- Compensation committee must have authority to engage consultants, legal counsel and other advisors and have responsibility for overseeing their work
- Companies must provide compensation committee with appropriate funding
- Compensation consultants may be engaged only after taking into account certain factors that may affect independence

Claw-back Policy

- Required for all listed companies
- Provide for recovery of incentive-based compensation that is based on financial information that is subject to an accounting restatement
- Covers compensation paid during three years prior to restatement
- Disclosure of policy is required

New Compensation Disclosures

- **Use of Compensation Consultants** - whether the compensation committee retained and obtained the advice of a compensation consultant
- **Pay vs. Performance** - Show the relationship between executive compensation actually paid and the financial performance of the company
- **Relative Pay** - Disclose ratio of the median of annual total compensation of all employees, excluding the CEO, to the annual compensation of the CEO
- **Hedging** - Disclose whether employees and directors are permitted to hedge against any decrease in the value of company shares

Corporate Governance

- **Broker Voting** - Prohibits discretionary voting on the election of directors and executive compensation (Say on Pay)
- **Proxy Access** - Authorizes the SEC to adopt rules for proxy access
- **Chairman and CEO Structure** - Disclose the reasons why the company has chosen the same person to serve as chairman and CEO or why it has chosen different persons

Key Issues For Mutuals and MHCs

Mutual thrift charter is preserved

- Home Owners Loan Act continues
- No immediate statutory change to operations of mutual thrifts or mutual holding companies
- Law does not change or affect existing state statutes which provide for mutual state savings association or savings bank charters
- OTS continues to exist and regulate all thrifts and mutual holding companies until transfer date (July 21, 2011 - subject to six month extension)

Federal Mutual Savings Associations

- Federal mutual savings associations will be regulated by the Office of the Comptroller of the Currency (OCC), under a new Deputy Comptroller (same for federal stock thrifts)

State Mutual Savings Associations and Mutual Savings Banks

- The Federal Deposit Insurance Corporation will be the federal regulator for state mutual savings associations and savings banks (same for state stock thrifts); except FRB member banks will continue under oversight of Federal Reserve

Mutual Holding Companies

- The Federal Reserve will have federal regulatory oversight over both federally chartered and state chartered mutual holding companies

Home Owners Loan Act

- Authority to interpret and enforce, with respect to those provisions that govern federal mutual associations, is transferred to OCC
- Power to issue regulations for both federal and state mutual savings associations is transferred to OCC
- Authority to interpret and enforce provisions that govern state mutual savings associations and savings banks is transferred to FDIC

Savings and Loan Holding Company Act

- Authority to issue regulations, interpret and enforce those provisions governing mutual holding companies is transferred to Federal Reserve

- Not later than the transfer date (July 21, 2011, with up to one six month extension), the FRB and the OCC (in consultation with the FDIC) must each identify those former OTS regulations continued under the Act that will be enforced by each agency
- List of continued OTS regulations under the jurisdiction of each agency must be published in the Federal Register
 - o Unclear as to whether agencies can pick and choose which regulations to enforce or whether all OTS regulations will carry over to the applicable agency

- All orders, guidance, agreements, interpretive rules, etc. that were issued or allowed to become effective by OTS and that are in effect on transfer date will be enforceable by FRB, OCC and FDIC, as applicable
 - This would cover enforcement orders, legal interpretations and opinions, thrift and regulatory guidance and CEO Memoranda
- OCC, FRB and FDIC retain authority to modify or terminate any such orders, guidance, agreements, etc.

- FRB required to establish consolidated leverage and risk-based capital requirements for all depository institution holding companies - includes mutual holding companies and their mid-tier subsidiaries
 - o Components of capital as stringent as for insured depository institutions
 - o Five year phase in for SLHCs, including MHCs and Mid-Tier Stock HCs

Implications

- Requires that consolidated capital requirements for all savings and loan holding companies; eliminates instruments such as cumulative preferred stock and trust preferred securities from inclusion as tier 1 capital

Transition Rules/Exemptions

- Grandfather of existing instruments issued before May 19, 2010 for holding companies of \$15 billion or less in total assets
- Permanent grandfather for debt/equity instruments issued before May 19, 2010 by mutual holding companies in existence on that date

Notice of Dividends

- Bank subsidiary of MHC must provide 30 days notice to FRB prior to declaration of dividend
- Dividends declared prior to notice are void

Dividend Waivers

- Only grandfathered MHCs may waive dividends
- Grandfathered MHC is one that was in existence on December 1, 2009; had minority shares outstanding; and had waived dividends
- No dividend waivers permitted for any other MHCs

Standards for Dividend Waiver

- Grandfathered MHC
- Would not be detrimental to safe and sound operations of savings association
- Board of MHC expressly determines that waiver is consistent with fiduciary duties of board to mutual members of MHC

Practice

- Act provides that the FRB may not object to a waiver of dividends if it meets the standards above; but it does not prohibit the FRB from objecting
 - FRB has historically opposed dividend waivers by MHCs - how high will the hurdle be to receive approval?

Second Step Valuation

- Waived dividends shall be considered in determining appropriate exchange ratio in event of full conversion
- Exception - Banking regulator shall not consider waived dividends in valuations of grandfathered MHCs (in MHC form, minority stock outstanding, and dividends previously waived before 12/1/2009)
- Uncertainty as to application of 12/1/2009 date

Recent Events

- Year to date 2010 - Seven (7) second-step conversions completed; Two (2) second-step conversions in offering stage; and six (6) second-step conversions on file or announced

- Regulations, policies and interpretive guidance of OTS transferred to OCC on federal charter and bylaw matters
- OCC (and the state banking regulators) have historically taken a less patriarchal approach to corporate governance matters than the OTS
 - o Possible effects on charter and bylaw provisions for mutuals and MHCs
 - o Possible effect on member rights

- Charter conversions of troubled institutions are prohibited unless both current regulator and future regulator agree
- Future regulator must give written notice to current regulator and agree to implement plan to address the supervisory issue of the converting institution

- Federal banking agencies required to adopt guidance requiring financial institutions to disclose information on all incentive based compensation
 - o Purpose - to allow regulators to determine if such compensation provides any executive, employee or director with excessive compensation, fees or benefits or could lead to a material loss to the financial institution
 - o Exemption - does not apply to financial institutions with less than \$1 billion in assets
 - o Mutuels - No specific language in statute to exempt mutuels or mutual holding companies; appears to be required for all depository institutions

Best Practices - the Act requires the SEC and the stock exchanges to adopt rules addressing, among other things, independence of compensation committees and clawbacks

- Rules do not apply to private companies
 - o Question - Will these rules evolve as best practices for all financial institutions both public and private?
 - o Recent release of guidance by bank regulators on risk evaluation of compensation practices

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Questions?