Financial Reform

Landmark Financial Reform

On July 21, 2010, President Obama will sign into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The provisions are designed to help prevent problems that led to the 2008 financial crisis from recurring. In some cases, the legislation enacts specific measures; in others, it authorizes the creation of regulations that will be determined in coming months.

The following is a summary of key provisions of the legislation:

Regulatory supervision

- Eliminates the Office of Thrift Supervision and transfers its functions to the Comptroller of the Currency.
- Authorizes the SEC to review how investment brokers, dealers and investment advisors are regulated and impose a universal fiduciary responsibility standard if appropriate. It also establishes within the SEC the office of Investor Advocate.
- Establishes a Consumer Financial Protection Bureau within the Federal Reserve to oversee financial products and services from mortgage lenders, banks and credit unions with more than $10 billion in assets, payday lenders and check cashing services (but not loans from auto dealers and pawnbrokers).
- Requires hedge funds and private-equity advisors to register with the SEC and disclose to the SEC information such as amount of leverage, investment positions, and counterparty risk. The SEC also will study whether to establish a self-regulatory organization to oversee the industry.
- Creates an Office of Federal Insurance, reporting to the Secretary of the Treasury, to recommend changes in the patchwork system of insurance regulation, and monitor the industry to determine which insurers might be threats to the overall financial system.

Credit and lending practices

- Requires lenders to determine a borrower's ability to repay a loan--for example, by verifying income and other data on a mortgage application.
- Limits prepayment penalties when a borrower repays a loan early.
- Restrains lenders from providing financial incentives that induce mortgage brokers or loan originators to steer customers to a higher interest rate mortgage simply to increase their commission.
- Orders the Federal Reserve to look at reducing fees charged to retailers for consumer use of debit cards, and permits retailers to offer a discount for payments not made with a credit card.
- Requires a lender to retain at least 5% of a loan on its books if the loan is sold or and/or securitized, though some relatively low-risk mortgages, such as fully documented loans with a fixed interest rate, are exempted.

Monitoring and management of systemic risk

- Establishes a Financial Stability Oversight Council to assess and manage risks that could threaten the entire financial system. The Council would consist of the Treasury Secretary and heads of various existing agencies, such as the Securities and Exchange Commission (SEC), Federal Deposit Insurance Commission (FDIC), and Federal Reserve Board, as well as an insurance expert appointed by the President.
- Establishes a procedure for the FDIC to liquidate a troubled financial institution whose failure might affect the stability of the nation's financial system.

Investment and banking provisions

- Makes over-the-counter derivatives more transparent and easily monitored by requiring that they be traded on a public exchange or clearinghouse. Nonstandard derivatives could still be traded privately, but would be reported to a central authority.
- Restricts banks' ability to engage in proprietary trading in their own accounts (this is the so-called Volcker Rule).
- Requires banks to hold additional capital to cover potential losses and set up separate operations to handle risky derivative trades such as swaps.
- Increases the fees that large banks pay to support FDIC deposit insurance, and redirects unspent funds from the TARP program rather than charging banks and hedge funds a fee to cover the costs of implementing the new legislation.
- Allows states to adopt restrictions on national banks that are more stringent than federal standards, and gives state attorneys general the authority to enforce some of the Consumer Financial Protection Agency's regulations.

Miscellaneous

- Makes permanent the $250,000 ceiling on FDIC insurance for bank deposits.
- Modifies the accredited investor standard to exclude the value of a principal residence from the $1 million net worth threshold, and provides for periodic subsequent reviews of the definition of "accredited investor."
- Gives the SEC the ability to oversee and discipline credit rating firms, fining those that issue too many faulty ratings over time. The SEC also will determine whether a new governmental agency is needed to oversee credit rating agencies.
- Allows investors to sue credit-rating agencies for issuing securities ratings that they knew or should have known were flawed.
- Gives shareholders of publicly held companies a nonbinding vote on executive compensation. Also, the SEC will review whether to mandate that shareholders be able to nominate their own candidates for a company's board of directors.