BANKING LEGISLATION & POLICY

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HIGHLIGHTS

This issue contains detailed descriptions of:

- The Proposed Financial Reform Bills, including:
    - The Financial Stability Improvement Act
    - The Over-the-Counter Derivatives Market Act
    - The Consumer Financial Protection Agency Act
    - Discussion Draft of a Senate Bill
- Housing Assistance Developments, including:
    - Continued Assistance to Fannie Mae and Freddie Mac
    - Initiatives to Help Low- and Middle-Income Borrowers Obtain Mortgages
    - Clarified Mortgage Modification Standards
    - Stricter Rules for Mortgage Originators

In addition, it summarizes other notable legislative, regulatory, and judicial developments that occurred during the fourth quarter of 2009.

FINANCIAL REFORM BILLS

On December 11, the House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173).[1] The bill, which was proposed by Rep. Barney Frank (D-Mass.) on December 2, proposes numerous changes to the United States' financial regulatory framework that could have a tremendous impact on the industry. It includes provisions that would heighten supervision of systemically important firms and credit rating agencies, change compensation rules for financial firms, require over-the-counter derivatives to be cleared on exchanges, create a Consumer Financial Protection Agency, and create a Federal Insurance Office.

On November 10, Senate Banking Committee Chairman Christopher Dodd (D-Conn.) released a discussion draft of the "Restoring American Financial Stability Act of 2009." This bill, which has yet to be reported out of committee, addresses the same issues as the passed House bill but proposes some different provisions.

[1] This bill replaces several other bills by incorporating their language into a single piece of financial reform legislation. The absorbed bills were H.R. 2609, H.R. 3126, H.R. 3269, H.R. 3795, H.R. 3817, H.R. 3818, H.R. 3890, and H.R. 3996.

Financial Stability Improvement Act

Title I of the bill, the Financial Stability Improvement Act, includes provisions that are designed to mitigate systemic risk from large, interconnected financial institutions by increasing oversight of these firms and enhancing the Federal Deposit Insurance Corporation's (FDIC) resolution mechanism for those that are failing.

Financial Services Oversight Council Established

The bill would establish a Financial Services Oversight Council that would be charged with identifying the systemically important firms that would be subject to the stricter regulations. This council, which would be composed of the heads of the Treasury, the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC), the Commodities Futures Trading Commission (CFTC), the FDIC, the Federal Housing Finance Agency (FHFA), the National Credit Union Administration (NCUA), and two state-level representatives, would work to identify potential threats to financial stability, subject large financial firms to strict prudential standards, and resolve disputes among regulatory agencies.

Although it would not have the authority to issue general regulations, the council would work with the Federal Reserve to impose stricter standards on individual systemically important financial firms. To determine which firms were important enough to merit enhanced regulations, the council would take into account whether some combination of the nature, scope, size, scale, concentration, or interconnectedness of a company's activities could pose a threat to the economy if the company were to become distressed. These firms would be subject to higher risk-based capital requirements, as well as leverage and short-term debt limits; these standards would also apply to the companies' off-balance-sheet activities. In addition, each firm would be required to have in place a rapid resolution plan that takes into account its exposure to and from other large financial firms.

Quarterly stress tests of these firms would be conducted by the council; undercapitalized companies would be required to either submit restoration plans or face "prompt corrective action" to replenish their capital. In addition, the council would have the ability to force a company to terminate or limit specific activities if its market share or its concentration within the firm were too great, or if the council determined that the firm needed to limit its risk-taking activities. The council could also limit the growth of a financial firm to prevent it from becoming too-big-to-fail or could force it to sell assets or branches to rein in its size.

The council would also have the authority to subject a specific activity or practice to stricter standards if it were to determine that the size or interconnectedness of the activity could increase the risk of significant problems spreading among financial institutions or markets. Any policies would be coordinated with the Federal Reserve, which would publish the final rules.

Dissolution Authority for Large, Interconnected Financial Companies Act

Currently, when a large nonbank financial firm is in distress, it has two options: It can file for bankruptcy, potentially leading to systemic effects (e.g., Lehman Brothers), or it can request assistance from the U.S. government, putting taxpayer funds at risk (e.g., AIG). The bill would address this problem by enhancing the FDIC's resolution authority for systemically important financial firms.

If the Federal Reserve, in consultation with the SEC and other regulatory agencies, were to determine that a systemically important financial company was either in default or in danger of default, the FDIC would be appointed receiver for the company and immediately begin the dissolution process. The company would not need to have failed yet; imminent risk of insolvency would be enough to begin the process.

The dissolution process would be similar to the resolution process the FDIC currently undertakes for failed commercial banks. The FDIC would operate the company either directly or through the formation of a bridge company (to which the assets and liabilities of the failed institution would be transferred) for up to five years. It would have the ability to make loans to the company, purchase or guarantee its debts, or sell its assets to another financial institution. It would also have the ability to disallow certain claims, which would not be reviewable by any court.

To cover the costs of such actions, the FDIC would establish a new Systemic Dissolution Fund, which would be financed by charging assessments to financial companies that have assets of $50 billion or more. Assessments would also be levied against financial companies that manage hedge funds with $10 billion (adjusted for inflation) or more of assets. The amount of individual assessments would be determined by the size, risk profile, systemic importance of the firm, and its likelihood of failure. The maximum size of the fund would be $150 billion, beyond which assessments would be suspended. Should the fund become depleted due to dissolution of firms, the FDIC would have a line of credit with the Treasury to cover any gap.

Emergency Financial Stabilization

To better manage future financial crises, the FDIC and Federal Reserve would have explicit new powers under the bill. These powers would be effective only if the council were to determine that there is a liquidity problem that could destabilize the financial system.

In such an emergency, the FDIC would have the authority to create a "widely available" program that would guarantee the obligations of solvent, insured financial institutions. Such a program would be funded through loans from the Treasury that would be repaid through assessments on program participants or on large financial institutions (regardless of whether they were to participate in the program). The FDIC could not use funds from the Deposit Insurance Fund (DIF) or the Systemic Resolution Fund to finance the program. In addition, the bill would require the FDIC to receive warrants to purchase stock in any company to which it provided credit or guarantees.

The Federal Reserve would be able to authorize any Federal Reserve Bank to discount notes, drafts, and bills of exchange for an individual, partnership, or corporation. Such discounting would have to be broadly available, not just for specific individuals or companies. The assets available for discount would have to be of high quality and secured to such an extent that the Federal Reserve believed there was a 99 percent chance that the funds disbursed would be fully repaid with interest. Up to $4 trillion could be available for such disbursements.

Credit Risk Retention Act

Based on the belief that securitization encouraged lax underwriting standards in the mortgage markets, this bill would require creditors and securitizers to retain an economic interest in loans that are bundled to form asset-backed securities (ABS). They would be required to retain 5 percent of the credit risk on any loan that is transferred, sold, or conveyed by a creditor or securitized by a securitizer and would be prohibited from hedging or transferring this risk.

Office of Thrift Supervision Abolished

Under the bill, the Office of Thrift Supervision (OTS) would be abolished, with most of its responsibilities being transferred to the OCC. The FDIC would become the regulator for state savings associations, and the Federal Reserve would become the regulator for all savings and loan holding companies. The transfer of functions would occur within one year of the enactment of the law, and the OTS would be officially abolished 90 days after the transfer was complete.

Corporate and Financial Institution Compensation Fairness Act

Title II of the bill, the Corporate and Financial Institution Compensation Fairness Act, contains provisions that would change compensation practices for executives of corporate and financial firms. Members of the compensation committee of the board of directors of a firm would need to be independent, meaning that, aside from their positions on the board of directors or their committees, they could not receive any consulting, advisory, or other compensation from the firm. Furthermore, shareholders would be required to approve executive compensation packages proposed by the compensation committee, including golden parachute provisions, through a nonbinding vote.

Financial institutions would also be required to disclose the structures of all incentive-based compensation packages. The regulators would then determine whether the structures contained any perverse incentives that could encourage executives to take excessive risks. Regulators would be required to write rules governing these disclosures within nine months of the bill's enactment.

Over-the-Counter Derivatives Market Act

Title III of the bill, the Over-the-Counter Derivatives Market Act, would require most over-the-counter (OTC) derivatives, including futures contracts and swaps, to be cleared on exchanges. Currently, many of these products are unregulated, traded with little oversight or transparency. The power to regulate these markets would be shared by the SEC and the CFTC. The products underlying the swap would determine which commission would be the primary regulator: The SEC would handle security-based swaps, while the CFTC would handle most others.

Swap repositories, dealers, major participants, and swap execution facilities would be required to register with the regulators; this requirement would extend to both domestic and foreign participants. The SEC and CFTC would be required to create uniform rules governing these groups within 180 days of the enactment of the bill.

Standardized OTC derivatives would need to be centrally cleared by a registered clearinghouse. Regulators would have the authority to set margin and capital requirements for derivatives traded on the exchanges. They would also have the authority to set aggregate position limits for individual traders, thus preventing any one party from accumulating an excessive concentration of risk or market power. Furthermore, the SEC and CFTC would be able to ban "abusive" trading practices if they believed them to be detrimental to the stability of a financial market or its participants.

Consumer Financial Protection Agency Act

Title IV of the bill, the Consumer Financial Protection Agency Act, would establish a new, independent Consumer Financial Protection Agency (CFPA) to regulate the provision of consumer financial products and services. These include, among other activities, taking deposits; providing consumer credit products such as mortgages, personal loans, and credit card loans; servicing loans; engaging in payday lending; collecting debts; leasing property; and offering financial advice. The director of the CFPA would be appointed by the president to a five-year term.

All consumer financial protection functions from the Federal Reserve, the OCC, the OTS, the FDIC, the Federal Trade Commission (FTC),[2] the NCUA, and the Department of Housing

[2] The FTC would maintain some of its consumer protection functions as prescribed in the Credit Repair Organizations Act,

and Urban Development (HUD) would be transferred to the CFPA, creating a single central agency that would be tasked with "promot[ing] transparency, simplicity, fairness, accountability, and equal access in the market for consumer financial products [and] services." It would curb unfair, deceptive, or abusive acts or practices by standardizing and enhancing disclosure requirements and by performing background checks on and licensing financial service providers. To directly assist consumers, the CFPA would provide consumer financial education, license financial educators, and be responsible for fielding all consumer complaints. It would have primary enforcement authority over any violations of its regulations.

The CFPA's authority to regulate consumer financial products would not apply to credit extended directly by a merchant, retailer, or seller of nonfinancial services to a consumer, nor to the collection of such a debt directly by the merchant. However, if the credit is transferred, including for purposes of collection, the CFPA's regulations would apply. They would also apply if the value of the credit extended were to significantly exceed the market value of the nonfinancial product or service. The authority would also not apply to accountants, tax preparers, attorneys, real estate licensees, and auto dealers. The CFPA's regulations would not preempt any rules of the SEC, the CFTC, the FHFA, or state insurance regulators.

The CFPA would be able to prohibit or regulate mandatory arbitration agreements in consumer financial contracts. However, it would not be able to impose any usury limits, nor could it require anyone to offer a specific product or service. It would also be required to develop risk-based programs to supervise nondepository financial institutions.

Capital Markets Provisions

Title V of the bill contains numerous provisions that would affect capital markets, including requiring private fund investment advisers to register with the SEC, enhancing disclosure from ratings organizations, and enacting new standards of conduct for consumer investment advisers.

Private Fund Investment Advisers Registration Act

The Private Fund Investment Advisers Registration Act would eliminate the exemption for private investment advisers (primarily hedge fund managers) to not register with the SEC. Under the bill, all investment advisers, except for venture capital fund advisers and those with funds with less than $150 million in assets, would have to register and be subject to regulation.

Accountability and Transparency in Rating Agencies Act

The Accountability and Transparency in Rating Agencies Act would allow the SEC to review the policies, procedures, and methodologies of all nationally recognized statistical rating organizations (NRSROs). These organizations have been criticized recently for having compensation structures that encourage rating securities as being of higher quality than the underlying assets would suggest. This bill would work to improve transparency at the NRSROs and manage conflicts of interest, thereby increasing the reliability of their ratings.

The SEC would examine the NRSROs to ensure that they were performing due diligence, enacting and following strict internal controls, and actually implementing their published methodologies for determining ratings. The firms would have to publicly publish the historical default rates for each of their ratings classes, differentiating between structured and other products. They would also have to publish for

Section 5 of the FTC Act, and the Telemarketing and Consumer Fraud and Abuse Prevention Act.

public viewing the assumptions they used to determine the ratings.

The SEC would issue rules to prohibit or require enhanced management and disclosure of conflicts of interest at the NRSROs. The firms would have to employ a compliance officer, whose salary would not be tied to the performance of the company, to perform internal analysis. To further limit conflicts of interest, NRSROs would be prohibited from providing any nonrating financial services.

Investor Protection Act

The Investor Protection Act would establish new standards of conduct for brokers and dealers who provide investment advice to retail customers. A broker would have to inform a consumer if he were selling only proprietary financial products or a limited range of products. Brokers and dealers would also be held to a standard requiring them to act in the best interest of their customers when selecting products, regardless of the financial impact on the brokers themselves. They would also need to more explicitly disclose any conflicts of interest to the consumers.

Federal Insurance Office Act

Title VI of the bill, the Federal Insurance Office Act, would establish a Federal Insurance Office within the Treasury. The office would monitor the U.S. insurance industry, identifying gaps in regulation and recommending specific firms for stricter regulation by the Financial Services Oversight Council. It would also coordinate federal policy on matters of international insurance and resolve matters of preemption regarding state insurance regulations.

Discussion Draft of Restoring American Financial Stability Act Released

While the draft of the Restoring American Financial Stability Act largely echoes the provisions of the House bill, it does differ in some important aspects.

Rather than establishing a Financial Services Oversight Council, the draft would create the Agency for Financial Stability (AFS) that would consist of a chairperson appointed by the president; the secretary of the Treasury; the chairpersons of the Federal Reserve, the CFPA, the SEC, the FDIC, the CFTC, the new Financial Institution Regulatory Administration (discussed below); and an independent expert who would be charged with monitoring systemic risk. The AFS would subject systemically important financial institutions and bank holding companies (BHCs) with $10 billion or more in assets to heightened prudential standards and assign otherwise unregulated companies to be supervised by a federal regulator.

The House version would immediately charge assessments on large financial firms to create a Systemic Dissolution Fund that would cover the potential costs of placing a systemically important firm into conservatorship. This draft offers a similar resolution mechanism but would cover such costs by charging the assessments after the fact.

Whereas the House bill would merge the OTS into the OCC, the Senate draft would abolish both agencies and transfer their supervisory powers, as well as those of the Federal Reserve and the FDIC, into a new Financial Institution Regulatory Administration (FIRA). The FIRA would thus become a single regulator that covers most depository institutions.

The Senate draft would still require investment advisers to register with the SEC but would have fewer exemptions for small or specialized advisers. Broker-dealers would no longer be exempt from this requirement. Under the draft, NRSROs would not be prohibited from selling financial products or from acting as investment advisers as they would in the House bill, but they would have to separate their sales and marketing activities from their rating activities.

The bill has been introduced in the Senate Banking Committee, where it is undergoing debate and markup.

HOUSING ASSISTANCE DEVELOPMENTS

This quarter saw many developments in housing markets as government agencies continued to attempt to revive the struggling sector. Government agencies extended tax credits to homebuyers, offered additional support to the government-sponsored entities (GSEs) Fannie Mae and Freddie Mac, and worked to continue expanding access to mortgage loans for low- and middle-income borrowers. Regulators also clarified rules for banks seeking to initiate mortgage workouts for struggling borrowers and proposed new strict rules for mortgage originators.

Worker, Homeownership, and Business Assistance Act of 2009 Enacted

On November 6, the president signed into law the Worker, Homeownership, and Business Assistance Act of 2009 (Public Law No. 111-92), which offers tax credits to certain homebuyers. These credits were first instituted through the American Recovery and Reinvestment Act (Public Law No. 111-5) in January 2009 and were due to expire in December 2009. Under the new law, the tax credits have been extended through April 30, 2010. First-time homebuyers are eligible for an $8,000 tax credit, and existing homeowners are eligible for a $6,500 tax credit if they choose to purchase a new primary residence.

The bill also contains provisions that allow small businesses that experienced losses in 2008 or 2009 to claim refunds from previous taxes paid; in addition, the bill extends unemployment benefits for an additional 14 to 20 weeks.

Continued Assistance to Fannie Mae and Freddie Mac

On December 24, the Treasury announced several changes to its Preferred Stock Purchase Agreements (PSPAs) with the GSEs Fannie Mae and Freddie Mac. The PSPAs were instituted when the companies were placed into FHFA conservatorship on September 7, 2008.[3] They allow the Treasury to inject capital directly into the GSEs through purchases of preferred stock, ensuring that the companies remain solvent at all times.

The limit on these purchases was originally $100 billion per GSE, which was later increased to $200 billion.[4] Through the third quarter of 2009, the Treasury had provided $51 billion to Freddie Mac and $60 billion to Fannie Mae through the PSPAs. The new amendments remove any cap on Treasury assistance to Fannie Mae and Freddie Mac, allowing the Treasury to fully cover all losses incurred by the GSEs through December 31, 2012. In addition, the Treasury will delay setting and implementing the periodic commitment fee – the quarterly compensation to be paid by the GSEs to the Treasury – by one year, to December 31, 2010.

The Treasury is also making a minor change to the timetable for the GSEs to reduce the size of their portfolios of mortgages and mortgage-backed securities, which is required by the Emergency Economic Stabilization Act of 2008 (Public Law No. 110-343). The GSEs were allowed to grow their portfolios to as much as $900 billion each by the end of 2009. The original rule would have required them to then reduce their portfolios by 10 percent each year. Instead, this amendment will only reduce the maximum allowable size of their portfolios by 10 percent per year, which should give the GSEs more flexibility as they work to sell off some of their assets. The portfolios must ultimately shrink to $250 billion or less each.

[3] For more information on the government takeover of Fannie Mae and Freddie Mac, see *Banking Legislation and Policy*, Volume 27, Number 3.

[4] For more information on the first amendment to the PSPAs, see *Banking Legislation and Policy*, Volume 28, Number 1.

Initiatives to Help Low- and Middle-Income Borrowers Obtain Mortgages

Initiatives to Aid State Housing Finance Agencies

On October 19, the Treasury, the FHFA, and the GSEs Fannie Mae and Freddie Mac announced new initiatives to provide assistance to state and local housing finance agencies (HFAs). There are two initiatives: a Temporary New Bond Issuance Program (NBIP) and a Temporary Credit and Liquidity Program (TCLP). The goal of the initiatives is to support low interest rates and expand resources for low- and middle-income borrowers.

The NBIP provided temporary financing for the HFAs to issue new bonds to fund new mortgages and refinance existing mortgages for borrowers at risk of default. The Treasury purchased GSE-issued securities that were backed by these new housing bonds, temporarily increasing the ability of the HFAs to issue new bonds; all bond issuance under the program ended on December 1, 2009. The HFAs that participated in the program worked with the Treasury to determine their issuance limits. The HFAs will pay the Treasury interest at rates equal to a short-term Treasury rate on any undrawn funds and equal to the rate on a 10-year Treasury bill after the funds are drawn down. The HFAs will also pay the Treasury and the GSEs an additional fee to offset the risk to taxpayers.

The TCLP provides temporary credit and liquidity facilities to the HFAs through Fannie Mae and Freddie Mac; these temporary credit and liquidity facilities are designed to reduce the cost of financing to the HFAs. The Treasury will provide a backstop to the facilities by purchasing a participation interest in them. The HFAs had to be enrolled in the program by December 31, 2009. The facilities are only able to support existing housing bonds, thus limiting the size of the program. Fees paid by the HFAs to the GSEs and the Treasury for using the facilities will increase over time to encourage the HFAs to obtain private financing, but an exact schedule has not been provided.

FHFA Authorizes CDFIs to Become Members of FHLB System

On December 29, the FHFA approved a final rule (75, *Federal Register*, pp. 678-704) that authorizes community development financial institutions (CDFIs) to become members of a Federal Home Loan Bank (FHLB).

This rule, which was required by the Housing and Economic Recovery Act (HERA) of 2008 (Public Law No. 110-289), will offer CDFIs increased access to long-term funding that will assist them in accomplishing their missions. The CDFIs serve as intermediary financial institutions that promote economic growth and stability in low- and moderate-income communities, especially those that are typically underserved by conventional financial institutions.

Newly eligible CDFIs must have been certified by the CDFI Fund of the U.S. Treasury and include community development loan funds, venture capital funds, and state-chartered credit unions without federal insurance. The rule lays out eligibility requirements for the CDFIs to join the FHLB system, which include having sound management policies, meeting certain financial condition requirements, and submitting to inspection and regulation. The rule took effect on February 4, 2010.

Mortgage Modification Standards Clarified

Regulators Issue Guidelines for Risk Weighting of Modified Mortgages

On November 20, the OCC, the Federal Reserve, the FDIC, and the OTS issued a final rule to allow lenders to risk weight mortgages modified through the Treasury's Home Affordable

Modification Program.[5] According to a December 10 release, the Treasury has initiated more than 725,000 modifications through the program since its inception in March 2009.

In general, modified mortgages will retain the same risk weight that they carried prior to modification, as long as the loans continue to meet sound underwriting and performance standards. This risk weight is typically 50 percent for loans that have prudent underwriting and are not more than 90 days past due, and 100 percent for all other mortgages.

The rule became effective on December 21, 2009.

Prudential Standards for Lenders Undertaking Commercial Mortgage Workouts

On October 30, the Federal Reserve, the FDIC, the NCUA, the OCC, and the OTS issued a joint statement detailing prudential standards for financial institutions to implement commercial real estate (CRE) loan workouts. Many CRE borrowers are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting properties as a result of the recession. Avoiding foreclosure by initiating workouts is often more appealing to both lenders and borrowers as a way to maintain some of the loan's economic value.

The statement details risk-management practices for lenders engaging in workouts. The regulators offer prudent standards for assessing a borrower's repayment capacity, the quality of guarantees, and the value of collateral. Financial institutions that use these standards to perform comprehensive reviews of borrowers' financial conditions before initiating workouts will not be subject to criticism from regulators even if the restructured loans are given adverse credit ratings.

[5] For more information on the Home Affordable Modification Program, see *Banking Legislation and Policy*, Volume 28, Number 1.

Stricter Rules for Mortgage Originators

Proposed Rules for Originators, Brokers of FHA-Backed Mortgages

On November 30, the Federal Housing Administration (FHA) issued a proposed rule (74, *Federal Register*, pp. 62521-31) that would institute stricter standards on lenders seeking to originate, underwrite, or service an FHA-backed mortgage.

Mortgage brokers will no longer receive FHA approval to independently originate FHA-backed loans. Instead, the brokers will have to originate the mortgages through an FHA-approved lender, which will assume responsibility and liability for the loan. This will allow the FHA to focus on more effectively monitoring the originators and, through them, the brokers.

Lenders also face increased net worth requirements to ensure that they are sufficiently well capitalized and able to meet their obligations. Under the proposed rule, the current minimum net worth of $250,000 will increase to $1 million in one year and to $2.5 million within three years.

Comments on the proposed rule were due on December 30, 2009.

Proposed Rule to Set Standards for Licensing of Mortgage Loan Originators

On December 15, HUD issued a proposed rule (74, *Federal Register*, pp. 66548-62) to create uniform minimum licensing standards for mortgage loan originators to be enacted by the states. Under the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act of 2008, a part of HERA, states are required to create a licensing regimen for state-regulated mortgage originators.[6]

According to the proposed rule, originators must take pre-licensing education courses on lending ethics and federal regulations, pass a test on these subjects, and pass certain background checks. If a state does not meet these minimum

[6] For more information on the SAFE Act, see *Banking Legislation and Policy*, Volume 27, Number 2.

requirements by July 31, 2010, HUD may take over the state's licensing system.

Comments on the proposed rule were due by February 16, 2010.

Federal Legislation

Proposed Legislation

Small Business Financing and Investment Act of 2009 Proposed

On October 20, Rep. Kurt Schrader (D-Ore.) introduced the Small Business Financing and Investment Act of 2009 (H.R. 3854). The bill contains provisions that would expand eligibility and increase loan limits for certain Small Business Administration lending programs. The bill was passed by the House on October 29 and referred to the Senate Committee on Small Business and Entrepreneurship.

Tax Extenders Act of 2009 Proposed

On December 7, Rep. Charles Rangel (D-N.Y.) introduced the Tax Extenders Act of 2009 (H.R. 4213), which contains provisions that are designed to increase compliance with U.S. tax laws by consumers who hold accounts or assets abroad. Foreign financial institutions would be required to withhold 30 percent of payments from U.S. citizens unless the institutions disclose the identities of the individuals. U.S. citizens would also be subject to increased disclosure requirements regarding their foreign accounts. The bill was passed by the House on December 9 and referred to the Senate Committee on Finance.

Federal Regulation

The Board of Governors of the Federal Reserve

Final Rule Requires Debit Card Users to Opt-In to Overdraft Protection

On November 12, the Board of Governors of the Federal Reserve issued a final rule (74, *Federal Register*, pp. 59033-56) that amends Regulation E to prohibit banking institutions from charging overdraft fees on debit card or ATM transactions unless customers have opted in to the overdraft protection service. The rule goes into effect for new accounts on July 15, 2010; existing customers have until August 15, 2010, to opt in to the coverage. The rule was required by the Credit Card Accountability Responsibility and Disclosure Act, which was enacted in May 2009. For more details on the Credit CARD Act, see *Banking Legislation and Policy*, Volume 28, Number 2.

Proposed Rule to Restrict Fees on Gift Cards

On November 16, the Board of Governors of the Federal Reserve issued a proposed rule (74, *Federal Register*, pp. 60986-61012) that would restrict expiration dates and fees applied to prepaid cards, gift cards, and gift certificates. Comments on the proposed rule were due by December 21, 2009. The rule was required by the Credit Card Accountability Responsibility and Disclosure Act, which was enacted in May 2009. For more details on the Credit CARD Act, see *Banking Legislation and Policy*, Volume 28, Number 2.

Final Rule Establishing Eligibility Credit Rating Agencies for TALF

On December 4, the Board of Governors of the Federal Reserve issued a final rule (74, *Federal Register*, pp. 65014-7) that amends Regulation A to provide a process by which the Federal Reserve Bank of New York may determine the eligibility of credit rating agencies to issue ratings on asset-backed securities (ABS) to be used as collateral for loans made through the Term Asset-Backed Securities Loan Facility (TALF). An eligible agency must be registered as a nationally recognized statistical rating organization (NRSRO) and have experience issuing credit ratings for the specific type of assets being used as collateral. This rule, which is intended to create competition among rating agencies, became effective on January 8, 2010.

Final Rule on Risk-Based Pricing Notice
On December 22, the Board of Governors of the Federal Reserve System and the Federal Trade Commission issued a final rule (75, *Federal Register*, pp. 2724-84) that requires a creditor to provide a consumer with a risk-based pricing notice when, based on the consumer's credit report, the credit is offered at significantly less favorable terms than what is offered to other consumers. The rule, which implements section 311 of the Fair and Accurate Credit Transactions Act of 2003, was first proposed in May 2008 and will take effect on January 1, 2011. For more information on the rule, see *Banking Legislation and Policy*, Volume 27, Number 2.

Federal Deposit Insurance Corporation
Guidance Limits Interest Rates Paid on Deposits by Less Than Well-Capitalized Banks
On November 3, the Federal Deposit Insurance Corporation issued guidance that restricts the interest rate that less than well-capitalized institutions may pay on deposits. Rate caps will be based on the average of rates paid by U.S. depository institutions and will be updated every week. The guidance became effective on January 1, 2010.

Final Rule to Phase Out Debt Guarantee Portion of TLGP
On October 20, the Federal Deposit Insurance Corporation issued a final rule (74, *Federal Register*, pp. 54743-9) to phase out the Debt Guarantee Program (DGP) portion of the Temporary Liquidity Guarantee Program (TLGP). The DGP ceased making new guarantees on October 31, 2009, but this rule creates a six-month emergency funding facility for institutions that were already enrolled in the DGP. Institutions seeking to access the emergency facility will pay an annualized assessment rate of 300 basis points on any guaranteed debts. For more information on the TLGP, see *Banking Legislation and Policy*, Volume 28, Number 3.

Financial Accounting Standards Board
Banks Required to Consolidate Certain Variable Interest Entities
On December 23, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-17, Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This update amends a previous FASB final rule that requires banks to consolidate certain off-balance-sheet variable interest entities (VIEs) back onto their balance sheets in 2010 by creating new standards for consolidation. A company will now have to consolidate a VIE if it either has the power to direct the activities of a VIE that most significantly affect the VIE's performance or if it has the obligation to absorb the VIE's losses or the right to receive its gains. This rule is effective for all reporting periods that begin after November 15, 2009.

National Credit Union Administration
Proposed Rule to Clearly Define Community Charters
On December 17, the National Credit Union Administration proposed a rule (74, *Federal Register*, pp. 68722-31) to amend its community chartering policies. The rule would provide objective definitions for what constitute "well defined local communities," as well as rural areas. Comments on the proposed rule are due by March 1, 2010.

Securities and Exchange Commission

Final, Proposed Rules Requiring Additional Disclosure by NRSROs

On November 23, the Securities and Exchange Commission (SEC) issued a final rule (74, *Federal Register*, pp. 63832-65) that creates additional disclosure requirements for nationally recognized statistical rating organizations (NRSROs). The rule, which becomes effective on February 1, 2010, requires NRSROs to disclose histories for certain credit ratings in order to help investors evaluate which NRSROs did the best job in determining initial credit ratings and in making timely adjustments to these ratings. In addition, the SEC proposed new rules (74, *Federal Register*, pp. 63866-904) that would require additional disclosures by the NRSROs about their sources of revenue and potential conflicts of interest. Comments on the proposed rules are due by February 2, 2010.

Judicial Rulings

Circuit Court Rulings

Class Action Suit Under RESPA Alleging Kickback Scheme Allowed to Proceed

On October 28, the U.S. Court of Appeals for the Third Circuit reversed a lower court's order and will allow a class action suit that alleges that Countrywide Financial Corporation operated a kickback scheme with a private mortgage insurer in violation of the Real Estate Settlement Procedures Act (RESPA) (*Alston v. Countrywide Financial Corporation*, 3rd Cir., No. 08-4334, 10/28/09). The appeals court ruled that, even though the customers were not overcharged as a result of the scheme, their rights to real estate settlements that are "free from unlawful kickbacks and unearned fees" were violated, resulting in injury-in-fact.

Preemption of State Law Allows Banks to Collect Garnishment Fees

On December 14, the U.S. Court of Appeals for the Sixth Circuit affirmed a lower court's ruling that national banks can collect garnishment fees from garnished funds because state laws that would have prohibited such actions are preempted (*Monroe Retail, Inc., v. RBS Citizens N.A.*, 6th Cir., No. 07-4263, 12/14/09). When the banks transferred garnished accounts from debtors to merchants, if the funds were insufficient to cover both the merchants' claims and the banks' service fees, the banks would first collect their fees before passing the accounts on to the merchants. The merchants argued that this act of conversion is prohibited by Ohio law, but the court ruled that elements of the National Bank Act, which allow banks to charge and collect fees, preempt this particular conversion claim.

Plaintiffs Must Prove Detrimental Reliance to Recover Actual Damages Under TILA

On December 31, the U.S. Court of Appeals for the Third Circuit affirmed a lower court's ruling that a plaintiff seeking actual damages under the Truth in Lending Act (TILA) must prove that reliance on a deficient disclosure by a lender caused him to receive a worse deal than he could have sought elsewhere (*Vallies v. Sky Bank*, 3rd Cir., No. 08-4160, 12/31/09). The lender provided the plaintiff with a faulty disclosure that lumped a fee for debt cancellation insurance in with other finance charges, rather than as part of an itemized list. However, the court found that the plaintiff had received adequate information through other disclosures, and that he could not prove detrimental reliance as required under the TILA to recover actual damages. This opinion affirms decisions by other circuit courts that have considered similar cases.

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