



BANKING LEGISLATION & POLICY

October – December 2007

Volume 26, Number 4

HIGHLIGHTS

This issue contains detailed descriptions of [final rules to implement the Basel II capital accord](#), [legislative and regulatory proposals related to foreclosures and the subprime mortgage market](#), and [proposed rules that would regulate the accuracy of consumer credit reports](#).

In addition, it summarizes [other notable legislative, regulatory, and judicial developments that occurred during the fourth quarter of 2007](#).

Basel II Final Rules

In early November, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve, and the Federal Deposit Insurance Corporation approved [final rules](#) that will change the calculation of risk-based capital requirements for some large banks. The rules will implement the advanced approaches set forth under the international Basel Committee on Banking Supervision's New Capital Adequacy Framework, commonly known as Basel II. The implementation process was set to begin in January 2008, and the rules will be phased in over the next four years for banks adopting the new approach. Older Basel I rules will continue to govern most banks until the agencies issue new rules that offer them the option of adopting a less complicated Basel II-based approach.

The Basel Committee

The Bank for International Settlements, based in Switzerland, established the Basel

Committee on Banking Supervision in 1974 to facilitate international discussion of banks' capital adequacy and risk management processes with the aim of "improv[ing] the quality of bank supervision worldwide." The committee includes representatives from central banks and supervisory agencies in Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. The Basel Committee formulates guidelines and standards that individual member countries then implement independently based on the characteristics and needs of their own financial systems.

Under the Basel I and Basel II agreements, financial institutions are required to hold at least a minimum amount of capital to decrease the risk that they will become insolvent during poor economic conditions. The Basel regulations attempt to align regulatory capital requirements with the risk that banks assume; that is, banks with higher risk profiles are required to hold more regulatory capital.

RESEARCH DEPARTMENT FEDERAL RESERVE BANK OF PHILADELPHIA

Ten Independence Mall, Philadelphia, PA 19106-1574 • www.philadelphiafed.org

Basel I

In 1988, the committee adopted its first set of capital adequacy guidelines, now referred to as Basel I; by the end of 1992, the United States had fully implemented rules based on those guidelines for all banks. The Basel I guidelines established two tiers of regulatory capital. Core capital, also called “tier one” capital, consists of common shareholders’ equity, most retained earnings, and some perpetual noncumulative preferred stocks. Supplementary, or “tier two,” capital consists of subordinated debt, limited-life preferred stocks, and loan loss reserves that can total up to 1.25 percent of the risk-weighted assets. Together, these two categories must exceed 8 percent of the institution’s total risk-weighted assets.

Basel I also established five capital requirement “buckets” for assets, based on their perceived riskiness. Cash and bonds issued by OECD member governments, for example, are in the lowest-risk class, and banks are not required to hold any capital against them. On the other hand, banks are required to maintain capital exceeding 16 percent of the value of some high-risk asset-backed securities.

In recent years, there have been calls to modernize the capital rules. One criticism is that the asset classifications created under the Basel I “bucket” system are too broad. For example, all commercial loans require the same amount of capital backing, despite the large differences in risk among loans within that group. Second, banks often hold multiple financial instruments as hedges against each other. Although this actually reduces their portfolios’ overall risk levels, the Basel I rules did not take this into account. Finally, the Basel I rules do not explicitly address operational risk—the risk of loss due to human error, fraud, and similar factors.

Basel II

In June 1999, the Basel Committee on Banking Supervision proposed the

development of a New Capital Adequacy Framework to improve on Basel I. On August 4, 2003, the U.S. financial regulatory agencies issued an advance notice of proposed rulemaking seeking comment on the domestic implementation of the Basel II guidelines.¹ Over three years later, in September 2006, the agencies issued a joint notice of proposed rulemaking, which was then modified based on comments from the public to create the final rule.²

Since the agencies are adopting only the advanced approaches to calculating credit and operational risk capital requirements at this time, the final rules will affect only core and opt-in banks, a relatively small group. Banks with consolidated total assets of at least \$250 billion or consolidated total on-balance-sheet foreign exposure of at least \$10 billion are considered to be core banks, as are all depository institution subsidiaries of banks that will use the advanced approaches. Opt-in banks are noncore banks that are not required to adopt the advanced approaches but do so voluntarily. The regulations will apply initially to about 10 large banks.

The Basel II accord consists of three pillars: minimum capital requirements for credit risk, market risk, and operational risk based on the degree of risk; supervisory review of institutions’ internal risk assessment processes and capital adequacy; and the promotion of market discipline through enhanced public disclosures.

The first pillar, which the final rule addresses in the most depth, requires banks to calculate minimum regulatory capital levels based on their exposure to different types of risk. It retains some of the basic concepts of Basel I: The definitions of regulatory capital are unchanged, and the minimum risk-based regulatory capital ratio remains the same (8 percent total qualifying

¹ The advance notice of proposed rulemaking is summarized in [Banking Legislation and Policy, Volume 22, No. 3](#).

² The joint notice of proposed rulemaking is summarized in [Banking Legislation and Policy, Volume 25, No. 3](#).

capital to total risk-weighted assets and 4 percent core capital to total risk-weighted assets). The new rules, however, alter the calculation of credit risk and now account for operational risk.

The advanced internal ratings-based (IRB) approach to calculating credit risk allows banks to apply risk-based capital formulas to their own estimates of key risk parameters in order to calculate the amounts of capital they are required to hold. The model is similar to the credit value-at-risk approach already used internally by many banks; it sets the risk-based capital requirement to cover an amount of unexpected credit loss that banks are very unlikely to exceed over a one-year horizon. Under the IRB approach, banks must hold enough capital to ensure that there is a 99.9 percent chance that their unexpected credit losses will not exceed the requirement. Parameters included in the model include probability of default, loss given default, and exposure at default.

For wholesale exposures, which are credit exposures to companies, individuals, and sovereign and other governmental entities that are managed on an individual basis, the model also includes effective remaining maturity and values that capture the portfolio's diversification, since a more highly diversified portfolio should pose less risk in an economic downturn.

To calculate operational risk, core and opt-in banks will use the advanced measurement approach. This approach allows banks to use their own risk management systems, processes, and methodologies to assess their exposure to operational risk and calculate capital requirements, although each bank's approach requires the approval of its federal supervisor.

To address Basel II's second and third pillars, the rules describe how banks will be supervised and require banks to publicly disclose information about their capital structure, risk exposures, and risk assessment processes in order to promote greater transparency and market discipline. In addition, all banks that are subject to

the final rule are required to publicly disclose their total and tier one risk-based capital ratios and the ratios' components.

Significant Changes

The agencies received a number of comments on the advance notice of proposed rulemaking and incorporated several changes into the final rule. Notably, under the proposed rules, if aggregate minimum required risk-based capital had declined by 10 percent or more upon implementation of the new rules, the agencies would have revised the regulations to moderate that effect. The final rule eliminates this requirement in response to comments indicating that the aggregate limit was too different from foreign regulations and would add uncertainty to banks' capital planning processes.

In addition, the final rule's definition of default for wholesale exposures was modified to match the new accord's definition because of concerns that a different definition "would result in competitive inequities and significant implementation burden without associate supervisory benefit." In the final rule, a wholesale obligation is considered to be in default if the bank believes that the obligor is unlikely to repay the obligation in full without certain types of recourse by the bank or if the obligor is 90 days past due. The proposed rule would have used conditions more similar to those used by bank risk managers.

Under the proposed rule, opt-in banks were required to calculate the expected loss given default (ELGD) for each wholesale exposure and every segment of retail exposure in their portfolio. This was defined as "the bank's empirically based best estimate of the default-weighted average economic loss per dollar of [exposure at default] the bank expected to incur in the event that the obligor of [a wholesale] exposure...defaulted within a one-year horizon." ELGD is not a variable included in international Basel II rules, however, and a number of those offering comments

complained that requiring U.S. banks to calculate ELGD would significantly increase their regulatory burden, putting them at a competitive disadvantage vis-à-vis banks in other countries. In response, the agencies removed the ELGD risk parameter from the formulas in the final rule.

The final rule also takes into consideration the use of factors, such as insurance, that can absorb potential losses due to operational risk with sufficient certainty. The rule allows for the acceptance of other mitigating factors over time, provided that they “cover potential operational losses in a manner equivalent to holding regulatory capital.”

In the final rule, regulators also altered public disclosure requirements to make them more similar to those proposed under the Basel Committee’s new accord; for example, most public disclosure requirements will apply only to the institution “representing the top consolidated level of the banking group that is subject to the advanced approaches.”

Implementation

The agencies will implement the advanced approaches over a four-year period beginning on January 1, 2008. First, each bank is required to complete a successful year-long parallel run during which it operates under the old risk-based capital rules while also calculating and reporting its risk-based capital ratio under the new advanced approaches.

After they finish their parallel run periods, banks will begin to use the advanced approaches but will be subject to one of three transitional limits on any decline in their required risk-based capital. Each transitional floor period will last for at least one year, and each bank’s graduation from one period to the next requires supervisory approval. During the first transitional floor period, banks will be required to hold at least 95 percent of the capital that would be required under the old risk-based capital rules, even if the risk-based capital

requirements generated by calculations using the advanced approach are lower. During the second period, the transitional floor percentage will decrease to 90 percent, and during the third, it will fall to 85 percent. After they complete the third transition period, banks will move to full Basel II compliance.

Competitive Concerns

According to the text of the final rule, “a fundamental objective of the New Accord is to strengthen the soundness and stability of the international banking system while maintaining sufficient consistency in capital adequacy regulation to ensure that the New Accord will not be a significant source of competitive inequity among international banks.”

At least two sources of potential inconsistency arise in the U.S. implementation of Basel II. First, by issuing only the advanced approaches, the agencies will create a bifurcated set of risk-based capital rules within the United States. The agencies recognize that this could affect competition between the banks that adopt the advanced approaches and the banks that retain the general approaches. To address this issue, the agencies issued a proposal in December 2006 that would allow banks that do not adopt the advanced approaches to adopt optional modifications to the general risk-based capital requirements.³ In early 2008, the agencies plan to replace this proposed rule, known as Basel IA, with a new proposal that would allow noncore banks to adopt credit risk and operational risk approaches that are more consistent with those outlined in the new accord.

Second, implementation and application of the new accord varies internationally, meaning that banks in different countries are subject to somewhat different Basel-based rules. Some commenters on the rule expressed concerns that differences in the U.S. implementation of the new

³ See [Banking Legislation and Policy, Volume 25, No. 4](#) for more information on the Basel IA proposal.

accord guidelines, as well as the delayed implementation schedule, would put American banks at a competitive disadvantage. In response, the agencies modified the final rule to make it more similar to the new accord and emphasized U.S. participation in the Basel Committee's international efforts to promote the consistent application of the Basel guidelines.

Foreclosure Prevention and Subprime Regulation

Over the past several months, policymakers have introduced a number of proposals to prevent foreclosures and dampen disturbances in the subprime mortgage market. Among the most prominent are a foreclosure and loss avoidance framework, developed by the American Securitization Forum and supported by the White House, and several federal bills.

Background

Subprime mortgages are housing loans issued to borrowers who are perceived to pose a relatively high risk of default. These loans often have nontraditional features, including low initial payments that reset to a higher level as the loan matures. The subprime market has grown rapidly in recent years. While only 5 percent of all mortgages originated in 1995 were subprime, about 20 percent were subprime by 2005.⁴ In November 2007, payments on 15 percent of securitized first lien subprime adjustable rate mortgages (ARMs) in the United States were 60 or more days delinquent. About an additional 10 percent of first lien subprime ARMs had already entered the foreclosure process.⁵ The increase in subprime

foreclosures has been blamed largely on slowing house price appreciation and a loosening of underwriting standards. In many cases, lenders failed to verify borrowers' income, assets, and other factors that might affect their ability to repay their loans.

Policymakers are concerned about the increases in default and foreclosure rates on subprime mortgages for several reasons. First, losing a home through foreclosure can be financially and emotionally traumatic for a borrower, often reducing their future access to credit and housing. Foreclosures can have negative spillover effects on the prices of nearby homes. Foreclosure is also a lengthy and expensive process for lenders and servicers. The deteriorating performance of subprime mortgages contributed to the sharp contraction that occurred in financial markets' liquidity in early August. Institutions and individuals around the world that had invested in securitized packages of the loans suddenly encountered unexpected losses and became less willing to lend.⁶

American Securitization Forum Foreclosure Avoidance Framework

On December 6, President Bush introduced a [foreclosure and loss avoidance plan](#) that was formulated by the American Securitization Forum (ASF).⁷ The plan applies to any securitized first lien subprime residential ARM that features an initial fixed rate period of 36 months or less; was originated between January 1, 2005, and July 31, 2007; and will undergo an initial reset in interest rate between January 1, 2008, and July 31, 2010.

⁴ [Testimony of Sandra F. Braunstein](#), Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, March 27, 2007.

⁵ [LoanPerformance ABS Loan Level Data Extract with calculations by the Federal Reserve Bank of New York](#).

Approximately 75 percent of subprime mortgages originated in 2006 were securitized.

⁶ For more detail on the recent liquidity issues, see [Banking Legislation and Policy, Volume 26, No. 3](#).

⁷ The American Securitization Forum builds consensus within and advocates on behalf of the securitization industry. Its membership includes individuals and businesses participating in all parts of the securitization process, including issuers, investors, banks, and servicers.

Under the plan, mortgage servicers are instructed to contact borrowers at least 120 days before the initial rate reset to assess their ability to manage their payments and, if needed, to explore possible modification strategies. After contacting borrowers, servicers will classify their subprime ARM loans into three groups. Segment 1 loans are current in payments, and a Segment 1 borrower is likely to be able to refinance into “any available mortgage product, including FHA, FHA Secure, or readily available mortgage industry products.” Segment 2 loans are also current, but borrowers are judged not to be likely to be able to refinance. All current loans with loan-to-value ratios of 97 percent or more are placed in this category. Any loan that is not current, an indication that the borrower is already having trouble making payments under the low introductory rate, is grouped in Segment 3.

Under the ASF framework, servicers will encourage Segment 1 borrowers to refinance if they are unable or unwilling to maintain their payments after the interest rate reset. Servicers are expected to execute the refinancing to avoid incurring prepayment fees, if possible, which “may be accomplished by timing the refinance to occur after the upcoming reset date,” according to the ASF statement.

Segment 2 borrowers, who are expected to have difficulty managing higher payments after an interest rate reset and are unable to refinance into different loan products, may be eligible for fast-track loan modifications. To qualify, a borrower must occupy the mortgaged property as his or her primary residence and pass a FICO test: The borrower’s current FICO score must be less than 660 and must not exceed his or her FICO score at origination by more than 10 percent. In addition, the servicer must determine that the borrower’s mortgage payments would rise by at least 10 percent after the interest rate reset.

Under fast-track modification plans, eligible borrowers’ interest rates will be frozen at their

current levels for five years. If a servicer is unable to obtain written consent to the plan, the servicer is permitted to modify the loan and consider two subsequent months of completed payments to express the borrower’s implicit consent. When Segment 2 loans do not qualify for fast-track modification, servicers are asked to gauge the need for loan modification and, where appropriate, offer tailored loan modifications based on independent analysis of individual borrowers’ financial condition.

Segment 3 loans are not eligible for fast-track modification, but servicers are expected to develop loss mitigation strategies that will maximize the net present value to the securitization trust and are permissible under the mortgages’ pooling and servicing agreements (PSAs). Suggested approaches include “loan modification (including rate reduction and/or principal forgiveness), forbearance, short sale, short payoff, [and] foreclosure.”

Servicers’ ability to modify mortgages to avoid foreclosure is limited by PSA agreements that govern the management of securitized mortgage products. The ASF plan is designed to comply with typical PSAs, but in cases of incompatibility, servicers are required to adhere to their PSAs. In December, the Internal Revenue Service reassured real estate mortgage investment conduits that it will not challenge their special tax status if they modify mortgages at risk of foreclosure.

Related Federal Legislation

Mortgage Forgiveness Debt Relief Act of 2007

On December 20, President Bush signed the Mortgage Forgiveness Debt Relief Act of 2007 ([H.R. 3648](#)) into law. Under the new law, taxpayers will be permitted to exclude from their taxable income up to \$2 million of indebtedness forgiven through foreclosure or mortgage renegotiation on a principal residence that has occurred since the beginning of 2007. The law also extends the tax

deduction for private mortgage insurance premiums through 2010 and allows a taxpayer to exclude up to \$500,000 in gains from the sale of a principal residence within two years of the death of a co-owning spouse.

Under the original version of the bill, which was introduced by House Ways and Means Committee Chairman Charles Rangel (D-N.Y.) on September 25 and approved by a 386-27 vote on October 4, the tax exclusion would have been permanent, but the Senate reduced it to a three-year period in the version it passed unanimously on December 14. Most provisions of the law go into effect immediately.

Mortgage Reform and Anti-Predatory Lending Act of 2007

The House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act of 2007 ([H.R. 3915](#)) on November 15 by a 291-127 vote. The bill, which was introduced by Rep. Brad Miller (D-N.C.) on October 22, would require the licensing and registration of mortgage originators and would increase their responsibilities to borrowers by establishing a “duty of care” standard. Specifically, originators would be barred from steering borrowers toward loans with predatory characteristics. Under the bill, an originator would also be prohibited from collecting steering compensation that varied with the terms of the mortgage.

Residential mortgage lenders would be required to verify potential borrowers’ ability to repay their loans, and when lenders failed to do so, borrowers would have an individual cause of action to seek rescission against assignees, including mortgage securitizers who did not take certain minimum actions to make the loan conform to legal standards. Prepayment penalties would be prohibited on subprime mortgages, and mortgage creditors and servicers would be required to provide borrowers with written notice at least six months before the introductory interest rate on a

hybrid adjustable rate mortgage reset to a variable interest rate.

The bill would expand the coverage of protections under the Home Ownership and Equity Protection Act by keeping the APR trigger for coverage as a high-cost mortgage at eight percentage points above the APR of a comparable Treasury security for first lien mortgages while reducing the points and fees trigger to 5 percent for most loans. For these mortgages, the bill would prohibit balloon payments and some creditor-imposed fees. It would forbid creditors from recommending to borrowers that they default, and creditors would be required to verify that potential borrowers had received mortgage counseling and would be able to repay their loans.

FHA Modernization Act of 2007

The Senate passed the FHA Modernization Act of 2007 ([S. 2338](#)) by a 93-1 vote on December 14. The bill would increase the size of mortgages that the FHA is allowed to insure to the conforming loan size imposed on the housing GSEs, and it would prohibit seller-funded down payment assistance. It would reduce the minimum FHA down payment from 3 percent to 1.5 percent, delay the implementation of risk-based pricing by at least a year, and relax limits on the number and size of home equity conversion mortgages that the FHA can insure. The Senate will now attempt to develop a compromise with the House of Representatives, which passed a more ambitious FHA reform bill in September.⁸

Escrow, Appraisal, and Mortgage Servicing Improvements Act of 2007

The House Financial Services Committee approved the Escrow, Appraisal, and Mortgage Servicing Improvements Act of 2007 ([H.R. 3837](#)) on November 7. The bill, which was introduced by

⁸ See [Banking Legislation and Policy, Volume 26, No. 3](#) for information on the Expanding American Homeownership Act of 2007.

Rep. Paul Kanjorski (D-Pa.) on October 16, would require mortgage lenders to establish escrow accounts for taxes, hazard insurance, and other periodic payments. Unless the mortgage was terminated early, the bill would require the accounts to remain in existence for at least five years. A lender would be required to obtain an independent written appraisal of the property, and deceptive appraisals would be prohibited as unfair and deceptive lending practices.

Chapter 13 Bankruptcy Bills

On December 12, the House Judiciary Committee approved the Emergency Homeownership and Mortgage Equity Protection Act of 2007 ([H.R. 3609](#)), which was introduced in September by Rep. Brad Miller (D-N.C.). Under the legislation, mortgage lenders would be required to give timely notice to borrowers in Chapter 13 bankruptcy before charging them new fees. It would also allow a bankruptcy trustee to modify the rights of the holder of a mortgage on a principal residence during the bankruptcy process. Debtors facing foreclosure would no longer be required to seek credit counseling, as required under the Bankruptcy Abuse Prevention and Consumer Protection of 2005.

Sen. Arlen Specter (R-Pa.) introduced the Home Owners' Mortgage and Equity Savings (HOMES) Act ([S. 2133](#)) in the Senate on October 3. The bill would allow for the judicial modification of mortgages on a principal residence in a Chapter 13 bankruptcy filing, as long as both the creditor and debtor agree to the modification and the debtor's income is sufficiently low. For these debtors, the bill would also allow the prohibition or delay of interest rate adjustments, and Chapter 13 filers in foreclosure would be allowed to delay credit counseling until after they had filed for bankruptcy. The bill was forwarded to the Committee on the Judiciary, where it awaits further action.

Rep. Steve Chabot (R-Ohio) introduced a companion HOMES Act bill ([H.R. 3778](#)) in the House of Representatives on October 9. The bill is identical to the Senate version, except that it would not require written agreement from the creditor and debtor before allowing judicial modification of a mortgage. The bill is pending in the Committee on the Judiciary.

The Helping Families Save Their Homes in Bankruptcy Act of 2007 ([S. 2136](#)), which was introduced by Senate Majority Whip Richard Durbin (D-Ill.) on October 3, would allow Chapter 13 bankruptcy plans to modify the terms of mortgages on principal residences and allow the payment of the mortgages at fixed interest rates over 30 years for debtors qualifying under an income means test. The bill would exempt debtors in foreclosure from Chapter 13 credit counseling requirements and require court approval of additional mortgage fees assessed during bankruptcy. For all Chapter 13 debtors, the bill would allow courts to waive mortgage prepayment penalties. The bill is pending in the Committee on the Judiciary.

Related Federal Regulation

HUD Down Payment Assistance Rule

The Department of Housing and Urban Development (HUD) published a [final rule](#) on October 1 that will restrict the sources from which a home buyer can receive down payment assistance for FHA-insured mortgages. The final rule incorporates minor changes to the proposed version, which was published for comment on May 11. Under the final rule, down payment assistance cannot consist, in whole or in part, of funds provided by the seller, anyone who benefits financially from the sale, or any third party that is reimbursed by a party that benefits financially from the sale. The notice also clarifies that tribal governments are legitimate sources of down payment assistance.

The rule is motivated by concerns that the “assistance” does not actually help purchasers because sellers inflate sale prices to compensate for the cost of assistance. In fact, HUD estimates that borrowers who receive down payment assistance from seller-reimbursed nonprofit entities are two to three times more likely to default on their mortgage payments than are borrowers who receive down payment assistance from other sources. In addition, these borrowers are two to three times more likely to lose their homes than all other recipients of single-family FHA-insured loans.

The rule was to have gone into effect on October 31, but on that day, the U.S. District Court for the District of Columbia issued a preliminary injunction barring its enforcement until further order of the court, stating that the agency had failed to support the rule with a reasoned analysis or public data.

Proposed FACTA Credit Report Rules

The Federal Trade Commission, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision issued [proposed rules](#) on December 13 that would implement section 312 of the Fair and Accurate Credit Transactions Act of 2003. Under the rules, entities would be required to double check information that they had furnished for a consumer’s credit report at the consumer’s request.

In the U.S., furnishing information to credit reporting agencies is voluntary, so the rules are intended to increase credit reports’ “accuracy and integrity” while not creating undue burdens that would discourage furnishers from reporting. The agencies propose two alternative interpretations of the terms “accuracy” and “integrity,” which are not defined in the statute. Under the first approach, accuracy would be taken to mean that credit reports should be free of errors in their descriptions of the terms of accounts and consumers’ credit performance.

The “integrity” requirement, significantly, would address credit reports’ completeness: In addition to being accurate, voluntarily reported information about an account would be required not to “omit any term, such as a credit limit or opening date...the absence of which can reasonably be expected to contribute to an incorrect evaluation...of a consumer’s creditworthiness.” This potential requirement would have an important effect on some creditors who choose to report some data while withholding information like credit limits. The second proposed approach would avoid this issue by interpreting the integrity requirement to require only that information included on the credit report be reported in a nonmisleading format and be verifiable in the furnisher’s records.

Comments on the proposed rule, including the two interpretive approaches, were due on February 11, 2008.

Federal Legislation

Enacted Legislation

Terrorism Risk Insurance Program Reauthorization Act of 2007

On December 26, President Bush signed [H.R. 2761](#) into law. The bill, which will renew the Terrorism Risk Insurance Act for seven years, was passed in the House of Representatives on September 19 and, in amended form, in the Senate on November 16. The act establishes a federal backstop for terrorism insurance.

Passed in the House of Representatives

National Affordable Housing Trust Fund Act of 2007

On October 10, the House of Representatives passed [H.R. 2895](#) by a 264-148 margin. The bill, proposed by the chairman of the House Committee on Financial Services, Barney Frank (D-Mass.), would allocate the funds generated by affordable housing provisions in pending legislation to reform the FHA and the housing finance GSEs. The funds would be distributed by the Department of Housing and Urban Development and could be used for mortgage insurance and homeownership counseling, among other things. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

National Heroes Credit Protection Act

The House of Representatives passed [H.R. 513](#) by voice vote on November 5. The bill would allow members of the military to request that credit reports note their active military status as an explanation for credit delinquency or slow payments. The bill was introduced by House Administration Committee Chairman Robert Brady (D-Pa.) on January 7 and is now pending in the Senate Committee on Veterans' Affairs.

Small Business Programs Act of 2007

The House of Representatives passed [H.R. 3866](#) by voice vote on November 6. The bill would reauthorize small business programs, including the 7(a), Certified Development Company, DELTA, and Microloan programs, through the 2008 and 2009 fiscal years. The bill was introduced by House Small Business Committee Chairwoman Nydia Velazquez (D-N.Y.) and now awaits action in the Senate.

Homeowners' Defense Act of 2007

On November 8, the House of Representatives passed [H.R. 3355](#), which would strengthen state-sponsored natural disaster insurance programs by organizing a consortium of state-sponsored insurance funds and allowing them to pool their risk and issue securities. The bill, which was introduced by Rep. Ron Klein (D-Fla.), now awaits further action in the Senate Committee on Banking, Housing, and Urban Affairs.

Preserving and Expanding Minority Depository Institutions Act

On December 5, the House of Representatives passed [H.R. 4043](#), which would make the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency subject to existing federal regulations that require the Federal Deposit Insurance Corporation and the Office of Thrift Supervision to "preserve and promote" minority-run financial institutions. The House passed the bill, which was introduced by House Financial Services Oversight and Investigations subcommittee chairman Melvin Watt (D-N.C.), by voice vote.

Bill to Extend Consumer Protection Authority

The House of Representatives passed a bill ([H.R. 3526](#)) by voice vote on December 5 that would extend the authority to issue and enforce consumer protection rules affecting depository institutions to all of the federal banking agencies. Currently, the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board are the sole agencies with this power. The bill, which was introduced by House Financial Services Committee Chairman Barney Frank (D-Mass.), was forwarded to the Senate Committee on Banking, Housing, and Urban Affairs.

Passed in the Senate

Identity Theft Enforcement and Restitution Act of 2007

The Senate passed [S. 2168](#) by unanimous consent on November 15. The bill, which was introduced by Senate Judiciary Committee Chairman Patrick Leahy (D-Vt.), would strengthen federal prosecution of identity theft crimes. It would also enable prosecution for computer fraud offenses. The bill was forwarded to the House of Representatives, where it was referred to the House Committee on the Judiciary.

New Legislation

Credit and Debit Card Receipt Clarification Act of 2007

Rep. Tim Mahoney (D-Fla.) introduced [H.R. 4008](#) in the House of Representatives on October 30 to protect merchants from class action lawsuits alleging that they willfully violated the Fair and Accurate Credit Transactions Act by printing customers' credit card expiration dates on their receipts. Although FACTA does prohibit merchants from printing more than the last five digits of customers' credit card numbers, as well as expiration dates, many merchants who printed expiration dates believed that they were complying with the law. The bill was referred to the House committees on financial services and the judiciary.

Small Business Lending Oversight and Program Performance Improvement Act of 2007

Senate Small Business Committee Chairman John Kerry (D-Mass.) and Sen. Olympia Snowe (R-Maine) introduced [S. 2288](#) on November 1. The bill would improve oversight and transparency of the Small Business Administration's 7(a) and 504 lending programs. The bill awaits further action in the Small Business Committee.

Money Service Business Act of 2007

On November 1, Carolyn Maloney (D-N.Y.), chair of the House Financial Services Committee's Subcommittee on Financial Institutions and Consumer Credit, and Rep. Spencer Bachus (R-Ala.) introduced [H.R. 4049](#), a bill that would reduce the regulatory burden for banks that work with money-services businesses such as money transmitters and check cashers. Under the bill, banks' responsibility for monitoring the businesses would not extend beyond obtaining certification that they are not engaged in money laundering or terrorist financing. The bill was referred to the House Committee on Financial Services, where it awaits further action.

College Opportunity and Affordability Act of 2007

On November 9, Rep. George Miller (D-Calif.) introduced [H.R. 4137](#), a bill that would strengthen provisions against corruption in student lending, simplify the financial aid application process, and increase aid for veterans and military personnel, among other measures. The bill was referred to the House committees on the Judiciary, Science and Technology, Education and Labor, and Financial Services.

Notify Americans Before Outsourcing Personal Information Act

On November 15, Rep. Ted Poe (R-Texas) introduced [H.R. 4241](#), a bill that would require companies to provide customers with 90 days' advance notice before transferring their personally identifiable information to entities located outside the United States. The bill was referred to the House Committee on Financial Services, where it awaits further action.

Federal Regulation

Board of Governors of the Federal Reserve System

Unlawful Internet Gambling Enforcement Act Implementation

The Department of the Treasury and the Board of Governors of the Federal Reserve System released a [joint proposed rule](#) on October 4 to implement the Unlawful Internet Gambling Enforcement Act of 2006. The rule bars businesses from accepting payments made in connection with unlawful Internet gambling and requires certain financial institutions to implement policies to prevent the transfer of such payments. Comments on the proposed rule were due by December 12.

Electronic Consumer Disclosure Clarification

On November 9, the Board of Governors of the Federal Reserve System announced that it would adopt amendments to Regulations [B](#), [E](#), [M](#), [Z](#), and [DD](#) to clarify electronic consumer disclosure requirements. The amendments were released for public comment in April and will simplify [interim final rules](#) that were released in 2001 but were not implemented. The rules will go into effect on October 1, 2008.

Federal Deposit Insurance Corporation

Deposit Insurance Fund Reserve Ratio

The Board of Governors of the Federal Deposit Insurance Corporation [voted](#) November 5 to keep the 2008 designated reserve ratio for the deposit insurance fund at 1.25 percent of estimated insured deposits. The board sets the ratio between 1.15 and 1.50 percent each year at its own discretion.

Federal Trade Commission

Maximum Credit Report Fee Increase

On December 12, the Federal Trade Commission [announced](#) that it would increase the maximum amount that a credit reporting company can charge to a customer for a disclosure from \$10.00 to \$10.50. The charges are allowed under the Fair Credit Reporting Act and do not apply to the free annual credit report to which consumers are entitled. The increase became effective on January 1.

Internal Revenue Service

Patented Tax Planning Method Disclosure

On September 26, the Internal Revenue Service released a [notice of proposed rulemaking](#) that would require taxpayers to disclose whether they had paid to use a patented tax planning method, not including tax preparation software, to achieve a tax benefit. Patent holders would also be required to submit special disclosures. Comments on the proposal were due on December 26.

Office of the Comptroller of the Currency

Affiliate Marketing Solicitations

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration issued a [final rule](#) on October 25 requiring an individual or company to provide consumers with a reasonable opportunity to “opt out” of receiving marketing solicitations based on consumer information provided by their affiliates. This includes information from transactions, account applications,

and credit reports. The rules, which implement sections of the Fair and Accurate Credit Transactions Act of 2003, went into effect on January 1.

Office of Thrift Supervision

Thrift Reporting Change

On November 13, the Office of Thrift Supervision issued an [advance notice of proposed rulemaking](#) requesting public comment on rules that would change the type of document that thrifts are required to file with the agency. Currently, thrifts are required to file Thrift Financial Reports, but under the proposed rule, they would begin filing Consolidated Reports of Condition and Income (call reports) like other types of financial institutions. Comments were due by January 14.

Judicial Rulings

Truth in Lending Act Rescission Suits

On October 9, the Supreme Court upheld a California Court of Appeal ruling that borrowers cannot file class action rescission suits under the Truth in Lending Act ([LaLiberte v. Pacific Mercantile Bank, U.S., No. 07-160, cert. denied, 10/9/07](#)). According to the lower court's decision, rescission under the Truth in Lending Act was intended solely as an individual remedy.

Gift Card Dormancy Fees and Expiration Dates

On October 19, the U.S. Court of Appeals for the Second Circuit filed a decision upholding a Connecticut state law that prohibits gift card dormancy fees ([SPGGC v. Blumenthal, C.A. 2, Docket No. 05-4711](#)). The court also ruled that the National Bank Act prohibits states from banning gift card expiration dates, an act that the Connecticut law also made illegal.

Permissible Use of Consumer Information

An October 25 decision by the U.S. Court of Appeals for the Seventh Circuit rejected a class action suit alleging that a bank collected consumer information for an impermissible purpose, violating the Fair Credit Reporting Act ([Forrest v. Universal Savings Bank, F.A., 7th Cir., No. 06-4337, 10/25/07](#)). According to the court, a credit card offer made by Universal Savings Banks N.A. was "firm" and was therefore permissible.

Arbitration Agreement Application to Outrageous Tort

The Supreme Court announced on October 29 that it would not review a South Carolina Supreme Court decision that an arbitration agreement in borrowers' loan contracts with a consumer finance company did not apply to an outrageous tort in which employees stole borrowers' personal information ([World Finance Corp. of South Carolina v. Aiken, U.S. No. 07-248, cert. denied, 10/29/07](#)).

FACTA Class Action Lawsuits

A November 9 decision by the U.S. Court of Appeals for the Seventh Circuit cleared the way for a class action lawsuit claiming that a credit card company failed to provide clear disclosures to potential customers, despite the prohibition of this type of suit in the Fair and Accurate Credit Transactions Act of 2003 ([Killingsworth v. HSBC Bank Nevada N.A., 7th Cir., No. 06-1616, 11/9/07](#)).

FDIC Acceleration Clause Enforcement

The U.S. Court of Appeals for the District of Columbia ruled on November 13 that the Federal Deposit Insurance Corporation acted appropriately when it allowed a credit card business to continue operating after a bank failure, rather than accelerating payment to investors ([*The Bank of New York v. Federal Deposit Insurance Corporation*, D.C. Cir., No. 06-5358, 11/13/07](#)). The FDIC is permitted to ignore acceleration clauses when enforcing contracts, but the bank that failed was not an actual signatory to the contracts at issue. The court ruled that the bank had agreed to the contract's terms and had therefore entered into it.

OCC National Bank Enforcement Power

A December 4 ruling by the U.S. Court of Appeals for the Second Circuit upheld a district court's ruling that the Office of the Comptroller of the Currency is the sole enforcer of federal and state laws that regulate national banks ([*Clearing House Association v. Cuomo*, 2nd Cir., No. 05-5996, 12/4/07](#)). The ruling blocked New York Attorney General Andrew Cuomo from investigating New York national banks' compliance with anti-discriminatory lending laws.