HIGHLIGHTS

This issue contains detailed descriptions of:

- **Proposed Mortgage Loan Regulations**, including:
  - **Joint Proposal for Higher-Risk Mortgage Loans**
    - Scope of the Higher-Risk Mortgage Proposal
    - Proposed Appraisal Requirements
  - **CFPB Proposals for Mortgage Reform**
    - Mortgage Loan Origination Standards
    - TILA-RESPA Integrated Mortgage Disclosure and Finance Charge Amendments
    - High-Cost Mortgage Protections
- **Risk Management Standards for Systemically Important Financial Market Utilities**, including:
  - Purpose and Scope
  - Transparency and Fair and Open Access
  - Identifying, Managing, and Containing Risks
  - Advance Notice of Changes

In addition, it summarizes other notable legislative, regulatory, and judicial developments that occurred during the third quarter of 2012.

Proposed Mortgage Loan Regulations

**Joint Proposal for Higher-Risk Mortgage Loans**

On August 15, six federal financial regulatory agencies issued a proposal to establish new appraisal and disclosure requirements for higher-risk mortgage loans. The proposed revisions would implement amendments to the Truth in Lending Act (TILA) enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The six agencies include the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau (CFPB), the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, and the Office of the Comptroller of the Currency (collectively, the agencies). The proposal aims to create accurate and transparent procedures for assessing the value of property that the loan finances.

**Scope of the Higher-Risk Mortgage Proposal**

In accordance with the Dodd-Frank Act, the proposed requirements apply only to higher-risk mortgage loans. The Dodd-Frank Act defines a...
higher-risk mortgage loan as a loan that is secured by a consumer’s home and that has an annual percentage rate (APR) above the average prime offer rate (APOR) for a comparable type of loan at the time the interest rate is set. In general, mortgage loans are higher risk if the interest rate exceeds the APOR by 1.5 percent for first-lien loans, 2.5 percent for first-lien jumbo loans, and 3.5 percent for subordinate-lien loans. The proposal excludes qualified mortgages, which are defined separately by the CFPB in its “ability-to-repay” proposal. Under the proposal, creditors can make higher-risk mortgage loans only if the appraisal requirements discussed below are met.

Proposed Appraisal Requirements
The goal of the proposal is to enforce prudent lending practices by requiring tighter property appraisal standards for higher-risk mortgages than for standard mortgages. In order to make a higher-risk mortgage loan, creditors are required by the proposal to use a licensed or certified appraiser to inspect and write a report based on an evaluation of the property’s interior. The proposal also requires creditors to notify loan applicants about the appraisal and to provide applicants with free copies of any appraisal reports related to the property. Furthermore, under the proposal, it is the creditor’s responsibility to pay for an additional appraisal if the seller bought the property at a price lower than the current sale price within the past six months. The appraisal must provide justification for the price increase, such as changes in market conditions or property improvements. The agencies are waiting for public commentary before setting a threshold on the price increase that would trigger the requirement. The agencies seek comment on whether there should be a threshold price increase.

CFPB Proposals for Mortgage Reform
During the second quarter of 2012, the CFPB released numerous proposals aimed at improving mortgage-lending practices. The series of proposals would implement statutory changes made by the Dodd-Frank Act to TILA and the Real Estate Settlement Procedures Act (RESPA). The regulations for implementing these two acts are known as Regulation Z and Regulation X, respectively.

Mortgage Loan Origination Standards
On August 17, the CFPB proposed new mortgage loan origination practices, which aim to help borrowers understand and comparison-shop for mortgage loans and to standardize the qualifications of originators. The proposal would implement the Dodd-Frank Act’s amendments to TILA. The proposal requires lenders to offer mortgage applicants a no-point, no-fee loan option, unless the applicant does not qualify for the loan. This option is designed to create a point of reference for customers when comparing loans with different points, fees, and interest rates. The proposal also considers setting a minimum interest rate reduction for borrowers who pay points or fees up front in an attempt to ensure that borrowers receive value for paying up front.

In the same release, the CFPB also proposes to regulate mortgage loan originators’ qualifications, screening, and compensation in an effort to make

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1. The APR, which is useful for comparing the cost of loans, is an approximate measure of the cost of credit, expressed as an annual percentage rate. For example, if the APR on a loan is 10 percent, then the borrower would pay $10 for each $100 borrowed annually. The APR includes numerous types of loan charges and should not be confused with the interest rate.
2. The APOR is calculated from the average interest rates, points, and other loan pricing terms offered for low-risk loans by a representative sample of residential mortgage lenders. The CFPB publishes the APOR for a broad range of transactions weekly.
3. Jumbo mortgages are mortgage loans that exceed the conventional loan limits set by Fannie Mae and Freddie Mac.
4. For more information on qualified mortgages, see Banking Legislation and Policy, Volume 30, Number 2.
5. Appraisers must be certified or licensed by the state in which the property is located and conduct the appraisal in accordance with national standards.
originator standards consistent. The proposal advises that if an originator is not already licensed under the federal Secure and Fair Enforcement for Mortgage Licensing Act, then the originator’s employer must conduct additional training and tests as well as a background check to ensure the originator’s competence. Furthermore, the proposal prohibits originators from being compensated based on the terms of the loan they sell, the goal of which is to prevent originators from receiving incentives for giving consumers loans with higher interest rates or other unfavorable terms. The proposal would also prohibit originators from increasing loan amounts to cover single-premium credit insurance policies, with limited exceptions, and from including mandatory arbitration in the terms of the loan. The proposals regulating up-front points and fees and originator qualifications apply only to closed-end mortgage loans. The proposals to prohibit credit insurance premiums and lender-enforced arbitration apply to both closed-end and open-end mortgage loans.

TILA-RESPA Integrated Mortgage Disclosure and Finance Charge Amendments
On July 9, the CFPB released a proposal that aims to make mortgage disclosure forms easier for consumers to understand and to provide more protection for consumers against predatory lending practices. The proposal does not apply to reverse mortgages, mortgages secured by mobile homes, or five or less mortgage payments per year. Home equity lines of credit, or creditors who make five or less mortgage payments per year. The proposal integrates and simplifies various overlapping mortgage forms required by TILA and RESPA into just two forms – the Loan Estimate and Closing Disclosure forms – and includes a template for each of the forms. The proposal requires creditors to give consumers the Loan Estimate form within three days after they apply for a loan and the Closing Disclosure form at least three days before closing. The CFPB’s intention is for these forms to benefit consumers by simplifying the technical nature of loan documents and clearly presenting information about the terms of the loan on the front page instead of in the fine print. Providing consumers with clear loan information and options will help consumers understand the full costs and risks of mortgage loans. The proposal would also limit closing cost increases to 10 percent of the estimated cost stated in the Loan Estimate to prevent creditors from imposing costly, last-minute “closing shocks” on borrowers.

The proposal also redefines the term finance charge for the purpose of calculating the APR for closed-end mortgage loans by eliminating current exclusions. Currently, TILA defines a finance charge as any fee, direct or indirect, charged on a loan, but with many exclusions. The CFPB proposal eliminates most TILA exclusions in an attempt to more accurately reflect the cost of credit. The proposal would continue to exclude late, default, and delinquency fees; seller’s points; amounts paid into escrow accounts; and premiums for property and liability insurance if certain conditions are met.

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6 Credit insurance protects borrowers by making sure that payments are made toward a loan in the event that the borrower is unable to make payments and protects lenders by decreasing default risk. Types of credit insurance include life, disability, unemployment, health, and property insurance. Mortgage borrowers pay for credit insurance either through monthly premiums or a lump-sum single premium upon closing. Since borrowers can rarely pay for a single-premium policy up front, the single premium is added to the mortgage principal, which then increases interest payments as well.

7 In a closed-end mortgage loan, the principal amount is fixed and further borrowing using the same mortgage as collateral is not permitted. In contrast, in an open-end mortgage loan, the principal amount may be increased and further borrowing using the same mortgage as collateral is permitted.

8 For detailed instructions on how to calculate the APR, see the Truth and Lending Act, Appendix B, Section 226.

9 Examples of finance charges include interest, points, default and property insurance premiums, and credit report, service, and transaction charges.
High-Cost Mortgage Protections
Also on July 9, the CFPB proposed to amend the Home Ownership and Equity Protection Act (HOEPA), which would expand the scope of high-cost mortgage protection coverage and create new protections for high-cost mortgage borrowers. As defined in TILA, a mortgage loan is high cost if it exceeds the rate on Treasury securities of similar maturity by 8 percent for a first-lien loan and by 10 percent for a second-lien loan. A mortgage loan will also be considered high cost if its total points and fees exceed either 8 percent of the total loan amount or $611. Currently, refinance loans and closed-end home equity loans that exceed one or more of the APR thresholds are subject to HOEPA regulations. The proposal would expand the coverage of high-cost mortgage regulations to also include purchase-money mortgage loans and home equity lines of credit that meet any of the APR triggers.  

The proposal would further extend the scope of high-cost mortgage regulations by lowering the APR triggers, using the transaction coverage rate (TCR) as an alternative to the APR, and changing the benchmark from Treasury security rates to the APOR. Under the proposal, a mortgage would qualify as a high-cost mortgage loan if either the APR or TCR exceeds the APOR by 6.5 percent for a first-lien loan and by 8.5 percent for a second-lien loan. The proposal would also consider a loan to be high cost if its total points and fees exceed 5 percent of the total loan amount for loans less than $20,000 and 8 percent for loans greater than $20,000. The proposal would also consider a loan to be high cost if the creditor can impose a prepayment penalty more than 36 months after the borrower takes on a loan or if prepayment penalties are greater than 2 percent of the amount prepaid. Furthermore, the proposal bans prepayment penalties for high-cost mortgages. Thus, if the prepayment penalty on a mortgage exceeds the trigger (or if a mortgage meets any of the other qualifications that define it as high cost), then the lender is no longer allowed to charge any prepayment penalty. In effect, the proposal establishes a maximum prepayment penalty period and amount that non-high-cost mortgage lenders may charge.

The proposal would also prohibit balloon payment plans and fees for modifying loans and cap late fees and the amount creditors can charge for providing borrowers with payoff statements. Furthermore, high-cost loan borrowers would be required to receive mortgage counseling, and lenders would be required to provide borrowers with a list of housing counselors.

Risk Management Standards for Systemically Important Financial Market Utilities
On July 30, the Federal Reserve Board of Governors (FRB) finalized Regulation HH, which governs financial market utilities (FMUs) and implements

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10 For the rates of Treasury securities, see the Federal Reserve Board’s statistical release, Table H.15, Selected Interest Rates.
11 The Federal Reserve Board adjusts this set amount annually in accordance with changes in the consumer price index.
12 A purchase-money mortgage is a loan extended to the mortgage buyer by the seller of the property, rather than by a bank or financial institution. A seller may offer a purchase-money mortgage when a buyer is unable to obtain bank financing for the full amount of the mortgage. For example, if a house costs $120,000 but the bank only approves the borrower for a $100,000 mortgage, the seller may choose to finance the remaining $20,000 through a purchase-money mortgage. The purchase-money mortgage will usually be a second-lien loan and act as a second mortgage.
13 The TCR is calculated using only prepaid finance charges, which are fees paid prior to or upon closing, instead of all finance charges. The CFPB states that the TCR alternative to the APR will not be adopted if the expanded finance charge definition is not adopted.
14 The proposal calculates the APR using the expanded finance charge definition discussed in the TILA-RESPA proposal.
15 A prepayment penalty is a fee that lenders may impose if a borrower repays the loan earlier than scheduled, which deprives the lender of future interest payments.
16 Balloon payment plans require borrowers to pay a large lump sum toward the end of the loan repayment period.
17 A payoff statement states the loan’s balance.
sections 805 and 806 of the Dodd-Frank Act. An FMU is an entity that manages or operates a multilateral system for transferring, clearing, or settling payments, securities, or other financial transactions (such as funds transfers, securities contracts, forward contracts, repurchase agreements, swaps, and others) among financial institutions or between financial institutions and the entity itself. The Dodd-Frank Act authorizes the Financial Stability and Oversight Council (FSOC) to designate an FMU as systemically important.

The rule requires systemically important FMUs to follow additional risk management standards in their payment, clearing, and settlement activities. The rule also requires systemically important FMUs to provide the FRB with advance notice of any proposed changes that could affect the level of their risk. The rule took effect September 14, 2012. The following sections will further discuss the requirements of the rule.

**Purpose and Scope**

FMUs play a critical role in the financial system by providing the infrastructure to clear and settle payments and other financial transactions. If an FMU fails to operate efficiently, it may cause negative repercussions throughout the financial system. For example, if an FMU fails to promptly settle a transaction, it could cause liquidity problems for the counterparties and other FMUs. The Dodd-Frank Act created additional regulations to govern FMUs because of their potential systemic importance.

The rule applies to systemically important FMUs that operate as payment systems, central securities depositories (CSDs), and central counterparties (CCPs). The functions of these entities are explained below:

- Payment system FMUs set payment instructions, procedures, and rules governing the transfer of funds among participants to ensure the circulation of money. Payment systems enable consumer and commercial financial activities such as paying bills, purchasing goods and services, settling real estate transactions, and making foreign exchange transactions.
- Central securities depository FMUs hold securities either in certificate form or electronically on their books to enable securities transactions to be processed, transferred, or settled by book entry.
- Central counterparty FMUs, also known as clearinghouses, interpose themselves between counterparties of a transaction. Counterparties buy and sell to the central counterparty rather than directly with each other. In doing so, the central counterparty guarantees the performance of the underlying transaction and bears the credit risk.

The final rule’s risk management standards are based on the set of international standards developed by the Bank for International Settlements’ Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities and Commissions (IOSCO). These
international standards are known as the Core Principles for Systemically Important Payment Systems (Core Principles) and Recommendations for Securities Settlement Systems and Recommendations for Central Counterparties. The goal of the final rule is to establish standards for transparency, fair and open access, and identifying and evaluating risks; procedures for managing credit, liquidity, principal, and operational risks; contingency plans; and good governance. The following sections further discuss these requirements and how they apply to payment systems, CSDs, and CCPs (collectively, FMUs).

**Transparency and Fair and Open Access**

The final rule requires FMUs to establish transparency by clearly defining and publicizing the rights and obligations of all participants involved in FMU transactions. FMUs must also establish accountable and transparent governance procedures and controls. FMU transparency enables participants to understand the financial risks and costs that they incur from using the FMU’s services. The rule also requires FMUs to establish prudent criteria for participation and to publically disclose the criteria to permit fair and open access. Participation criteria may be based on the participant’s risk measures, such as capital ratios, risk ratings, or other indicators. FMUs may subject participants with greater risk exposures to more stringent participation criteria. The final rule also requires FMUs to establish a transparent legal framework for enforcing procedures as well as the obligations of participants.

**Identifying, Managing, and Containing Risks**

The rule requires FMUs to establish procedures for identifying, managing, and containing the major risks they face, which include credit, liquidity, market, operations, principal, settlement, and legal risks. In regard to managing risks, the rule requires FMUs to implement numerous procedures, including continuously monitoring and analyzing their risks in real time, setting exposure limits, and collateralizing obligations. FMUs are also required to maintain sufficient financial resources and create contingency plans so that they can complete settlements daily even if the participant with the largest settlement obligation is unable to settle or defaults. The rule also requires FMUs to settle transactions at a minimum by the end of the business day but recommends settling transactions in real time throughout the day to mitigate carrying credit and liquidity risks overnight.

In addition to these requirements, the final rule also requires CSDs and CCPs to eliminate principal risk by linking securities and funds transfers so that delivery of a security occurs only if the corresponding payment occurs. CSDs and CCPs must also regularly monitor participants and verify that participants have adequate financial resources and operational capacity to meet their payment obligations. CSDs and CCPs must also establish and publish their procedures for suspending participants that fail to meet participation criteria.

The rule also establishes additional requirements specifically for CCPs. The rule requires CCPs to measure their credit exposure to participants at least once a day. CCPs must also use risk-based models and parameters to set margin requirements and limit their exposure to potential losses. CCPs must review their risk-based models at least quarterly and use an independent agent to validate their models at least annually. The final rule

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22 To help achieve transparency and clarify participant obligations, the Core Principles recommend that FMUs provide participants with a clear description of the typical life cycle of a payment.

23 This method of linking transfers is known as delivery versus payment.

24 Generally, an independent agent may be a staff member within the CCP but must not participate in the development or use of the model or report to such a person. However, the FRB retains the authority to require an independent agent from outside the CCP to conduct the evaluation.
grants the FRB the authority to waive or increase risk management standards to systemically important FMUs on a case-by-case basis.\textsuperscript{25}

\textbf{Advance Notice of Changes}

The final rule also requires a systemically important FMU to give the FRB 60 days’ advance notice of any proposed changes that could affect its risk exposure, governance, or the performance of its payment, settling, or clearing activities. The notice must include documentation on the nature of the change, anticipated risks, and how the FMU will manage these risks. The FMU may not implement such changes without the FRB’s approval.\textsuperscript{26}

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\textbf{Federal Legislation}

\textit{Proposed Legislation}

On July 25, 2012, the House of Representatives passed the Federal Reserve Transparency Act of 2012 (H.R. 459) by a margin of 327 to 98. Introduced by Representative Ron Paul (R-Texas), this bill would direct the Government Accountability Office to audit the Board of Governors of the Federal Reserve System as well as the 12 Federal Reserve Banks. This audit would include a review of all monetary policy deliberations. The Federal Reserve Transparency Act of 2011 (S. 202), the companion bill to H.R. 459 in the Senate, has been referred to the Senate Committee on Banking, Housing, and Urban Affairs since its introduction by Senator Rand Paul (R-Kentucky) on January 26, 2011. However, S. 202 is not likely to be on the Senate agenda for the remainder of the 112th Congress.

On August 2, 2012, Representative Scott Garrett (R-New Jersey) and Senator David Vitter (R-Louisiana) both introduced the Terminating the Expansion of the Too-Big-To-Fail Act of 2012 in their respective legislative chambers. Both H.R. 6317 and S. 3497 would bar the Financial Stability Oversight Council (FSOC) from designating nonbank financial institutions, such as private equity firms and hedge funds, as systemically important. The FSOC, since it was designed to monitor the U.S. financial system for economic threats, was tasked with designating any nonbank financial firms as “systemically important financial institutions” if such firms were deemed by the FSOC to pose systemic risks. However, Representative Garrett and Senator Vitter want to eliminate that provision from the FSOC’s responsibilities because it extends the “too-big-to-fail” provisions to industries other than banking.

On September 10, 2012, Senator Robert Menendez (D-New Jersey) introduced the Responsible Homeowner Refinancing Act of 2012 (S. 3522) in the Senate. Under this legislation, all “underwater” Fannie Mae and Freddie Mac borrowers, regardless of the amount of equity invested in their home, would be eligible for low-cost mortgage refinancing under the Home Affordable Refinance Program (HARP). Currently, only those “underwater” Fannie Mae and Freddie Mac borrowers with less than 20 percent equity in their homes are

\textsuperscript{25} For example, the final rule notes that certain requirements are not applicable to retail payment systems, such as automated clearing houses. The rule clarifies that if a retail payment system is designated as systemically important, then the FRB has the authority to waive the nonapplicable requirements.

\textsuperscript{26} The final rule grants FMUs the authority to implement changes without advance notice only under emergency situations. However, the FMU must still submit documentation of these changes to the FRB for review within 24 hours of the change, and the FRB retains the authority to modify or rescind the changes.
eligible for low-cost mortgage refinancing under HARP. In addition, this new legislation would prohibit government-sponsored enterprises from charging up-front fees to refinance any loan they already guarantee and would ease representation and warranty requirements for mortgage lenders by directing government-sponsored enterprises to mandate the same underwriting practices and warranties for new servicers as they do for current servicers.

On September 11, 2012, the House of Representatives passed the FHA Emergency Fiscal Solvency Act of 2012 (H.R. 4264) by a margin of 402 to 7. Introduced by Representative Judy Biggert (R-Illinois), this bill would authorize the Federal Housing Administration (FHA) to collect additional insurance premiums from borrowers with less than 5 percent equity in their homes. Biggert’s bill would give the FHA the ability to raise some borrowers’ annual insurance premiums up to 2.05 percent of the outstanding loan balance and would establish a minimum annual premium for mortgage insurance at 0.55 percent. In addition, the FHA would be required to establish more frequent monitoring and assessment of early-term borrower delinquencies, which would be any 90-day delinquency within 24 months of a loan’s origination. At this time, this bill has been received in the Senate and has been referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Federal Regulation

Consumer Financial Protection Bureau

Finalized Exam Procedures for Consumer Reporting Agencies

On September 5, the CFPB released its objectives and procedures for examining credit bureaus and other consumer reporting agencies (CRAs). The CFPB’s examination of the credit reporting market is part of its larger nonbank supervision program, which was authorized by the Dodd-Frank Act. The CFPB will examine only “larger participants” in the consumer reporting market, which the CFPB defines as companies that have more than $7 million in annual receipts. In practice, this will cover an estimated 30 companies, which account for approximately 94 percent of the market’s total receipts and issue over 3 billion consumer reports a year.

The objectives of the examinations are to ensure that CRAs comply with federal consumer financial law. These requirements include providing accurate information, responding to consumer disputes, making disclosures and explanations available, and preventing fraud and identify theft. CFPB examiners will also evaluate a company’s management and controls to identify internal procedures that could compromise compliance. The CFPB will conduct its examinations using a combination of data collection, analysis, on-site visits, interviews, and follow-up monitoring. Examiners will report violations to the CFPB’s enforcement staff, which has the authority to enforce the appropriate changes. The CFPB’s authority over CRAs became effective September 30, 2012.

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27 The CFPB released the final rule for determining “larger participants” in the consumer reporting market on July 16, 2012, which became effective September 30, 2012. The final rule has few changes from the proposal, which was issued on February 16, 2012. For information on the proposal, see Banking Legislation and Policy, Volume 31, Number 1. For the final rule, see Federal Register, Volume 77, Number 140.
Commodity Futures Trading Commission

Finalized Swap Dealer Regulations

On August 27, the Commodity Futures Trading Commission (CFTC) finalized the rule governing “back office” activities of swap dealers (SDs) and major swap participants (MSPs). Back office activities include confirming swaps transactions and processing, netting, documenting, and valuing swaps. The rule sets procedures and standards to improve the risk management and efficiency of SDs and MSPs. For example, requiring SDs and MSPs to promptly confirm and document swaps transactions with counterparties will decrease risk by preventing confusion over swaps obligations. The rule finalizes three separate proposals that the CFTC issued in 2010 and 2011 and implements section 731 of the Dodd-Frank Act. The final rule differs slightly from the proposals rule by excluding swap execution facility or designated contract markets, which are already regulated by the CFTC and SEC under separate proposals and rules. The final rule went into effect on November 13, 2012.

Also in relation to swaps regulation, on August 16, the CFTC proposed to exempt certain affiliated swap transactions within a corporate group from clearing requirements. The rationale for the exemption is that interaffiliated swaps transactions are carried out as part of the common risk management program. The proposed exemption would apply only to majority-owned affiliates with consolidated financial statements. Furthermore, the affiliated counterparty must meet at least one of the additional conditions: the affiliate is located in the United States; is located in a jurisdiction with comparable swaps clearing requirements; is required to clear all swaps with nonaffiliated counterparties; or does not conduct swaps transactions with nonaffiliates. The proposal clarifies that affiliated counterparties are still subject to swaps transaction documentation, reporting, and risk management requirements.

On July 24, the CFTC further implemented swaps regulation by proposing new clearing requirements for certain swaps and finalizing procedures for phasing in swaps clearing requirements. The proposed rule, which applies only to credit default and interest rate swaps, would require these swaps to be cleared through a registered derivatives clearing organization. The proposal closed for commenting on September 6. The final rule divides swap market participants into three different categories, and clearing requirements are phased in based on these categories. The first category includes SDs, security-based SDs, MSPs, and major security-based swap participants. The second category includes commodity pools, private funds, and individuals who are predominantly engaged in financial activities (as defined by the Bank Holding Company Act). Finally, the third category includes all other swap participants. Respectively, the three categories are required to comply with clearing requirements within 90, 180, and 270 days after the CFTC publishes final clearing requirements.

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28 On April 18, 2012, the SEC and the CFTC released a joint final rule and interim final rule that defined swap dealer, major swap participant, and other terms frequently used in the swap market. For a summary of the rules, see Banking Legislation and Policy, Volume 31, Number 2. For the full rules, see Federal Register, Volume 77, Number 100.

29 These three proposals include Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants; Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants; and Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation. For a summary of these proposals, see Banking Legislation and Policy, Volume 30, Number 1, and Banking Legislation and Policy, Volume 29, Number 4.

30 For an explanation of swap execution facilities and designated contract markets, and their related proposals, see Banking Legislation and Policy, Volume 29, Number 4.
International Regulation

European Commission

Proposed Single Supervisory Mechanism

On September 12, the European Commission (EC) released a proposal to create a single supervisory mechanism (SSM) to restructure eurozone banking supervision and maintain financial stability. The SSM proposal grants the European Central Bank (ECB) authority to supervise and regulate approximately 6,000 banks located within the 17 countries of the eurozone.

The proposal gives the ECB the power to authorize new banks as well as to close down banks that fail to meet ECB criteria. The ECB also has the authority to set capital buffers and capital adequacy tests, banking governance standards, and other macro-prudential regulation. In addition to new regulatory authority, the proposal also transfers additional supervisory responsibilities to the ECB, which include assessing its acquisition and disposal of holdings, ensuring compliance with European Union (EU) banking rules, and conducting stress tests. Under the proposal, the ECB is also responsible for coordinating assessments for possible public recapitalizations with the EC. The proposal emphasizes that the ECB’s new responsibilities will be independent from its monetary responsibilities to avoid conflicts of interest.

The proposal also clarifies the role of the expanded ECB in relation to national authorities and the European Banking Authority (EBA). Under the proposal, the ECB is ultimately responsible for regulation and supervision related to financial stability and can instruct national authorities. National authorities would assist the ECB with preparing and implementing banking regulation. National authorities would maintain responsibilities not transferred to the ECB, including providing protection for customers, supervising payment services and non-EU bank branches operating in the EU, and preventing money laundering and terrorist financing. The proposal also clarifies that the expanded authority of the ECB would not affect the EBA and that ECB bank stress tests would not replace EBA stress tests. The EBA will continue its duties and work on standardizing EU banking regulation to prevent regulatory arbitrage within the EU. The EC aims to have the proposal approved by the Council of the European Union by January 2013 and fully implemented by January 2014.

31 The EBA was established January 1, 2011, to increase the transparency of the EU financial system by conducting stress tests to identify weaknesses in banks’ capital structures.

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