



Pratt's Letter

Ahead of the News/The Story Behind the News
The Washington Authority on Banking and Finance

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Dear Reader,

Community banks are outraged. They are suffering under the burdens of the Dodd-Frank Act, yet it seems nobody is really listening to their complaints. Meanwhile, no fewer than eleven federal agencies, including some new ones, are rushing to implement the many parts of Dodd-Frank. Just to make things worse, the Consumer Financial Protection Bureau — the worst of the agencies, bankers say — is off to a fast start.

Community Banks Continue to Criticize Dodd-Frank

Last week the banking industry observed the Dodd-Frank Act's first anniversary ("One Year Later: Dodd-Frank Anniversary," *Pratt's Letter* of July 25). We thought it was worth noting that Dodd-Frank continues to spark negative reviews from community banks.

A day after Dodd-Frank's birthday, the American Bankers Association (ABA) released a summary of Dodd-Frank's impact on community banks ("Cumulative Weight of New Regulations Rests Heavily on Community Banks and their Communities").

The ABA highlighted five Dodd-Frank provisions the ABA called particularly troubling:

- Risk retention;
- Changing capital requirements;
- SEC's municipal advisors rule;
- Derivative rules; and,
- The increasing size of the FDIC's Deposit Insurance Fund.

The ABA noted that Dodd-Frank has already resulted in over 3,900 pages of proposed and final rules.

"Managing this tsunami of regulation is a significant challenge for a bank of any size, but for the median-sized bank, with only 37 employees, it is overwhelming," the ABA added.

ICBA: Oppressive Exams and Over-Regulation

Along those lines, in a July 19 letter to House Financial Services Committee Chairman Spencer Bachus (R-Ala.) and Ranking Member Barney Frank (D-Mass.),

the Independent Community Bankers of America voiced its support for H.R. 2056. The bill would instruct the FDIC Inspector General to study the impact of insured depository institution failures.

ICBA President and CEO Cam Fine said the bill would help identify solutions to examination problems faced by community banks.

"The current oppressive exam environment is hampering lending at the very time that bank credit is needed to sustain the economic recovery," Fine wrote. "Good loan opportunities are passed over for fear of examiner write-downs and the resulting loss of income and capital. The contraction in credit is having a direct, adverse impact on the economic recovery. While all banks accept the need for balanced regulatory oversight, the pendulum has swung too far in the direction of over-regulation."

Fine added: "ICBA would welcome such a study, as it would focus on many of the serious concerns that we have identified with the current examination environment. In particular, studying the effect of 'paper losses' or 'write downs' that cause an institution to raise more capital, and commercial real estate loan 'workouts' will be very useful in raising awareness of these concerns, hopefully changing examination practices, and giving momentum to legislation that would directly fix examination problems."

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CFPB Reports on International Money Transfers

The Consumer Financial Protection Bureau (CFPB) — the agency established by the Dodd-Frank Act to protect consumers in the financial marketplace — released a report on international money transfers. The report recommends principles for maximizing consumers' ability to receive and use exchange rate information when making remittance transfers and examines the incentives and challenges related to using remittance data in credit scores.

The Dodd-Frank Act will require remittance transfer providers to disclose, in most circumstances, the exchange rates they use and other information at the time that consumers request remittance transfers and when they pay for those transactions. The Federal Reserve Board has proposed rules to implement those and other new requirements related to remittance transfers. The CFPB assumed responsibility for issuing final disclosure rules and will review comments received by the Board.

The CFPB's report recommends that, with respect to exchange rates, policymakers and other stakeholders observe four principles for enhancing consumers' ability to receive and use exchange rate information:

- Design, test, and use disclosures to maximize consumer comprehension;
- Facilitate consumers' comparisons of remittance offerings;
- Adapt disclosures to the growing variety of channels that consumers use to initiate remittance transfers; and
- Couple information about exchange rates with an indication or estimate of the combined effects of fees and the exchange rate.

The report finds that implementation of some of the Dodd-Frank Act's new requirements related to remittance transfers — including mandatory disclosures of the exchange rate used — could shed light on any need for additional exchange rate transparency measures. The CFPB recommends that any additional transparency measures be evaluated on their own and also considered together with alternatives. The agency recommends examining all the mechanisms available for increasing the competitiveness of the remittance transfer market.

The report also discusses the potential for using remittance histories in developing credit scores, and

describes planned CFPB research regarding the relationship between remittance histories and credit scores.

CFPB Off to a Fast Start

The Consumer Financial Protection Bureau (CFPB) is off to a fast start. In addition to recommending major new burdens for the money transfer business, the agency has produced a string of reports, recommendations, and general trouble-making activities — a remarkable list for an agency that has no Senate-confirmed director and isn't likely to get one any time soon. The CFPB rates these matters among its successes so far:

(1) The Treasury announced that Raj Date will replace Elizabeth Warren, Special Advisor to the Secretary of the Treasury for the CFPB, effective August 1. Date has had a career in financial policy, both with banking institutions and with a think tank he founded. Date's position is not agency director — ex-Ohio Attorney General Richard Cordray has been nominated for that post — but without a confirmed agency leader, Date will likely run the agency from Treasury, just as Warren did.

(2) The CFPB released a report examining the differences between credit scores sold to consumers and scores used by lenders to make credit decisions. Increasing transparency in situations like this will be a major part of the agency's mission.

(3) The CFPB's Consumer Response Center began accepting credit card complaints on its newly redesigned website, ConsumerFinance.gov, and through a toll-free number. It will also refer distressed homeowners to housing counselors via the Homeowner's HOPE Hotline. The agency plans to expand its Consumer Response Center to handle complaints about other consumer financial products and services under its jurisdiction.

In addition, as we reported earlier, the CFPB sent letters to the heads of big banks to introduce itself and welcome the banks to the agency's regulatory jurisdiction. It discussed coordination and mutual support with military lawyers. It announced plans for coordinating its activities with state attorneys general. And it announced it would propose a slew of regulations outlining the functions it has taken over from other agencies and how it will carry out these functions.

All in all, a busy place.

FinCEN Adopts Prepaid Access Rule

The Financial Crimes Enforcement Network (FinCEN) has adopted a final regulation that amends the agency's Bank Secrecy Act (BSA) rules relating to prepaid access services. The new regulation also amends the rules for money services businesses (MSBs) and establishes a more comprehensive regulatory approach for prepaid access.

The regulation adds new requirements — suspicious activity reporting and customer and transactional information collection — on providers and sellers of certain types of prepaid access. These requirements are similar to those in force for other categories of MSBs.

The final rule:

- Renames “stored value” as “prepaid access” to more aptly describe the underlying activity.
- Adopts a targeted approach to regulating sellers of prepaid access products, focusing on products whose inherent features or high dollar amounts pose heightened money laundering risks.
- Exempts from the rule prepaid access products of \$1,000 or less and payroll products if they cannot be used internationally, do not permit transfers among users, and cannot be reloaded from a non-depository source.
- Exempts closed-loop prepaid access products sold in amounts of \$2,000 or less.
- Excludes prepaid access programs that are funded by the government or by pre-tax flexible-spending programs.

The prepaid access final rule is mandated under the Credit Card Accountability, Responsibility and Disclosure Act of 2009. “Prepaid access” under the final rule covers prepaid devices such as plastic cards, mobile phones, electronic serial numbers, key fobs and/or other mechanisms that provide a portal to funds that have been paid for in advance and are retrievable and transferable.

FHFA Sues to Recover Fannie Mae, Freddie Mac Losses

The Federal Housing Finance Agency (FHFA) filed suit On July 27 alleging UBS Americas, Inc., violated the federal securities laws in the sale of residential

private-label mortgage-backed securities (MBS) to Fannie Mae and Freddie Mac. The suit, which FHFA brought as conservator for Fannie and Freddie, seeks to recover losses and damages sustained by the Enterprises as a result of their investments in \$4.5 billion in UBS Securities.

The lawsuit alleges that UBS and related defendants made numerous material misstatements and omissions about the mortgage loans underlying the private-label MBS, including the creditworthiness of the borrowers and the quality of the origination and underwriting practices used to evaluate and approve such loans. FHFA also claims the defendants failed to conduct adequate due diligence.

“FHFA is taking this action consistent with our responsibilities as conservator of each Enterprise,” said FHFA Acting Director Edward J. DeMarco. “From the issuance of 64 subpoenas last year to the filing of this lawsuit and further actions to come, we continue to seek redress for the losses suffered by the Enterprises.”

The defendants named in the lawsuit are UBS Americas, Inc.; UBS Real Estate Securities Inc.; UBS Securities, LLC; Mortgage Asset Securitization Transactions, Inc.; and former UBS executives David Martin, Per Dyrvick, Hugh Corcoran, and Peter Slagowitz.

FHFA indicated that it expects to file additional lawsuits.

Fair Credit Reporting — Changing of the Guard

On July 20, the day before the Dodd-Frank Act's “designated transfer date” of authority under a wide range of consumer financial protection statutes to the Bureau of Consumer Financial Protection (CFPB), the Federal Trade Commission withdrew its 1990 Commentary on the Fair Credit Reporting Act (FCRA). At the same time, the FTC issued a new staff report (“Forty Years of Experience with the Fair Credit Reporting Act: An FTC Staff Report and Summary of Interpretations”) that updates the agency's FCRA guidance.

The FTC acknowledged that the FCRA Commentary has become “partially obsolete” since its issuance in 1990. The FTC failed to keep the Commentary current with a number of FCRA statutory revisions, including the Consumer Credit Reporting Reform Act of 1996 and the Fair and Accurate Credit Transactions Act of 2003.

The FTC noted that the Dodd-Frank Act has transferred the authority to issue interpretive guidance under the FCRA to the Consumer Financial Protection Bureau (CFPB). “Withdrawing the 1990 Commentary now will ensure that this obsolete document does not transfer to the CFPB,” the FTC said.

FINRA Fines Bank Affiliates for Securities Violations

The Financial Industry Regulatory Authority (FINRA) has fined two Sun Trust investment affiliates a total of \$5 million for violations connected with the sale of auction rate securities (ARS).

FINRA found that beginning in late summer 2007, the firms became aware of stresses in the ARS market that raised the risk that auctions might fail. At the same time, the parent company, SunTrust Bank, sought to reduce the affiliates’ use of the bank’s capital and began to examine whether it had the financial capability in the event of a major market disruption to support all ARS in which it acted as the sole or lead broker-dealer.

As these stresses increased, FINRA said, the firm failed to adequately disclose the increased risk to its sales representatives, while encouraging them to sell the affiliates’ issues in order to reduce the firm’s inventory. As a result, certain sales representatives continued to sell these ARS as safe and liquid. In February 2008, one SunTrust affiliate stopped supporting ARS auctions, knowing that those auctions would fail and the ARS would become illiquid.

FINRA also found that one of the affiliates shared material non-public information regarding the potential refinancing of certain ARS issues with SunTrust Bank, which was contemplating investing in ARS. This information was material because SunTrust Bank was assured that if the auction market froze, it would likely be able to dispose of the illiquid ARS on the date the ARS were refinanced.

In addition, both affiliates used advertising and marketing materials that were not fair and balanced, and did not provide a sound basis for evaluating all the

Last Word:

“Part of it, I have to say, was gender bias. Along with Sheila Bair ... Warren encountered from some people, maybe unconscious on their part, the notion that a very strong-willed woman ... might have a place, but not in the financial sector.” — Rep. Barney Frank (D-Mass.) on why Elizabeth Warren was not appointed to be Director of the CFPB.

facts about purchasing ARS. The materials did not contain adequate disclosure of all the risks of ARS, including adequately disclosing the risk that ARS auctions could fail, rendering the investments illiquid for substantial periods of time. Both firms failed to maintain adequate supervisory procedures and training concerning their sales and marketing of ARS. The firms neither admitted nor denied the charges, but consented to the entry of FINRA’s findings.

Not Just for Bankers — Regulators and GAO Face Dodd-Frank Overload

Community bankers aren’t the only ones trying to cope with the burgeoning Dodd-Frank workload. In testimony before a House Financial Services subcommittee, the Government Accountability Office (GAO) testified on the estimated Dodd-Frank implementing costs for the eleven federal agencies that got new responsibilities under Dodd-Frank.

The GAO testimony focused on (1) the agencies’ funding estimates and the sources of funds associated with implementing the Dodd-Frank Act, (2) the agencies’ estimates of the number of new entities that will be created and the full-time equivalents (FTEs) they anticipate needing to carry out new responsibilities, and (3) the challenges the agencies faced in developing these estimates.

The amount of new funding the agencies reported as associated with implementing Dodd-Frank varied significantly across the 11 agencies. New funding resources related to Dodd-Frank responsibilities during the years 2011-2012 ranged from a low of \$0 for Federal Trade Commission (FTC) to a high of around \$329 million for Consumer Financial Protection Bureau. Most of the costs related to implementing the provisions will be recurring.

Excluding the three agencies that the Dodd-Frank Act created (CFPB, Financial Stability Oversight Council, and Office of Financial Research), the CFTC devoted the highest share of total agency resources (25 percent) to implementing the Dodd-Frank provisions.