

Dodd-Frank is
Coming: Are You
Ready?

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Dodd-Frank is Coming: Are You Ready?

- Agenda
 - Overview of the Dodd-Frank Act
 - Managing the risk and implementation of the Act



Overview of the Dodd-Frank Act

- Dodd-Frank Wall Street Reform and Consumer Protection
 - Signed into law on July 21, 2010
 - Total number of pages – 2,300+
 - Number of titles – 16
 - Rules and regulations called for by the Act – 290+
 - Estimated number of pages of new rules and regulations for Banks and BHC over the next few years – 5,000+



Overview of the Dodd-Frank Act

Title Number	Name
I	Financial Stability
II	Orderly Liquidation Authority
III	Transfer of Powers
IV	Regulations of Advisors to Hedge Funds and Others
V	Insurance
VI	Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions
VII	Wall Street Transparency and Accountability
VIII	Payment, Clearing and Settlement Supervision



Overview of the Dodd-Frank Act

Title Number	Name
IX	Investor Protections and Improvements to the Regulation of Securities
X	Bureau of Consumer Financial Protection
XI	Federal Reserve System Revisions
XII	Improving Access to Mainstream Financial Institutions
XIII	Pay it Back Act
XIV	Mortgage Reform and Anti-Predatory Lending Act
XV	Miscellaneous Provisions
XVI	Section 1256 Contracts



Title I – Financial Stability

- Creates new supervisory structure
- Creates the Financial Stability Oversight Council
- Primary impact is on large bank holding companies (“BHC”) with \$50 billion or more in total consolidated assets and nonbanks that are predominantly engaged in financial activities
- Publicly traded BHC with \$10 billion or more in consolidated assets are required to establish a Risk Committee. The FRB has the discretion to require the same for those below \$10 billion



Title I – Financial Stability

- Changes to capital requirements for bank holding companies
 - Requires regulators to establish minimum leverage capital ratios and minimum risk based capital requirements.
 - Large BHCs will be subject to the same capital standards as their subsidiary banks.
 - BHCs with less than \$500 million in assets are exempt



Title I – Financial Stability

- Trust Preferred Securities (TRUPs)
 - BHCs with greater than \$15 billion in assets at 12/31/09 to replace TRUPs with new Tier 1 capital or shrink balance sheet over 5 year phase out period
 - BHCs with greater than \$500 million but less than \$15 billion in assets as of 12/31/09 may retain TRUPS issued before 5/19/10 as Tier I capital permanently. Restricted on issuing new TRUPs.
 - Existing and new TRUPs will count as Tier I capital for BHCs under \$500 million in assets as of 12/31/09



Title II – Orderly Liquidation Authority

- Establishes the framework for liquidation by the FDIC of large institutions that pose systemic risk
- Types of institutions included are Broker/Dealers and Insurance Companies



Title III – Transfer of Powers

- The Office of Thrift Supervision (OTS) is being merged into the Office of Comptroller of the Currency (OCC)
- Federal Reserve will regulate savings and loan holding companies
- FDIC will regulate state savings associations
- Transfer of powers is underway



Title III – Transfer of Powers

- Deposit insurance reforms
 - Old insurance assessment base was domestic deposits less tangible equity
 - New base is average consolidated total assets less average tangible equity
 - The more non-deposit assets the greater the assessment
 - This may lead to more competition for deposit which in effect will increase your bank's cost of funds



Title III – Transfer of Powers

- Permanently increases the FDIC insurance per depositor from \$100,000 to \$250,000
- Increases the minimum reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35%



Title IV – Regulations of Advisors to Hedge Funds and Others

- Essentially requires advisors to private equity funds, hedge funds and venture capital funds to register with the SEC
- No effect on banks and bank holding companies



Title V - Insurance

- Establishes the Federal Insurance Office within the Department of the Treasury
- Will monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system



Title VI - Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

- National bank lending limit now includes derivatives, repos, reverse repos and security borrowings
- State bank to only engage in derivative transactions if the state legal lending law takes derivative credit exposure into account
- Permits national banks and out of state banks to open branches in states which allow branches to be opened by banks organized under that state's laws



Title VI - Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

- Allows for payment of interest on demand deposit accounts for businesses
- Require bank holding company or savings and loan holding company to serve as a source of financial strength for any subsidiary of the bank holding company or savings and loan holding company that is a depository institution.



Title VII – Wall Street Transparency and Accountability

- Increase the transparency of the OTC derivatives market
- OTC swap dealers and major swap participants have new capital and margin requirements and reporting obligations
- Security based swaps are subject to SEC oversight



Title VIII – Payment, Clearing and Settlement Supervision

- Activity carried out by 1 or more financial institutions to facilitate the completion of financial transactions
- Includes funds transfer, securities contracts, forward contracts, repos, swaps, etc.
- The purpose of this title is to mitigate systemic risk in the financial system and promote financial stability
- Regulators will determine what specific measures are necessary to ensure the sound functions of the systems



Title IX - Investor Protections and Improvements to the Regulation of Securities

- Seeks to protect investors
- Changes to executive compensation and corporate governance rules for publicly traded companies
- Permanent exemption of issuers who are not large accelerated filers or accelerated files from the attestation requirements of Sarbanes-Oxley



Title X - Bureau of Consumer Financial Protection

- Bureau of Consumer Financial Protection is born
- Housed within the Federal Reserve
- Regulate banks with assets in excess of \$10 billion
- Only rulemaking authority over smaller institutions
- Amendments to bank regulation to include the Bureau of Consumer Financial Protection
- Interchange transaction fees on electronic transactions will be regulated for institutions over \$10 billion in assets
- Smaller institutions below \$10 billion in assets are exempt



Title XI – Federal Reserve System Revisions

- Assistance from the Fed can only be to provide liquidity and not to assist in a failing institution
- Any loans must be adequately secured
- GAO to conduct a one time audit on the Fed's emergency lending from 12/07 – 7/10
- Provide Guarantee Program to healthy institutions during times of economic distress



Title XII - Improving Access to Mainstream Financial Institutions

- Encourage initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream
- Include grants to establish loan loss reserve funds and other non-mandatory programs



Title XIII – Pay it Back Act

- Reduce TARP funds from \$700 billion to \$475 billion
- June 25, 2010 cutoff to fund new programs under TARP
- Sale of Fannie Mae, Freddie Mac, FHLB obligations and securities by the treasury dedicated to debt reduction



Title XIV – Mortgage Reform and Anti-Predatory Lending Act

- Dramatic changes to mortgage lending
- To assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive
- Mortgage originator compensation shall not vary based on the terms of the loan other than amount of principal
- New high cost mortgage limitations and restrictions



Title XIV – Mortgage Reform and Anti-Predatory Lending Act

- Mortgage originators are prohibited from:
 - Steering a consumer to a residential mortgage loan that the consumer lacks the ability to repay or has predatory effects such as excessive fees or abusive terms
- Ability to repay standards
 - Consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial



Title XIV – Mortgage Reform and Anti-Predatory Lending Act

- Mortgage originators are prohibited from:
 - Steering a consumer from a qualified mortgage
 - Qualified Mortgage:
 - Does not allow for negative amortization or deferral of principal repayment
 - No balloon payment more than 2x earlier scheduled payment
 - Fully verified borrower income and financial resources
 - Meets debt to income guidelines established by Fed
 - Points and fees do not exceed 3% of loan amount



Title XIV – Mortgage Reform and Anti-Predatory Lending Act

- Prohibition on certain prepayment penalties
 - A residential mortgage loan that is not a ‘qualified mortgage’ may not contain terms for prepayment penalties
 - Adjustable rate loans and certain high interest rate loans are not considered qualified mortgages
 - Phased out penalties on qualified mortgages – No prepayment penalty may be imposed after 3 years
- Single premium credit insurance are prohibited from being financed
- No mortgages with negative amortization other than reverse mortgages with some exceptions



Title XIV – Mortgage Reform and Anti-Predatory Lending Act

- Establishes the Office of Housing Counseling which is responsible for all activities and matters relating to homeownership counseling and rental housing counseling
- Numerous changes to Truth-In-Lending Act and Real Estate Settlement Procedures Act
- Updating and simplification of the mortgage information booklet
- Periodic statements for residential mortgage loans
- Establishes new appraisal requirements for loans deemed to be higher risk



Additional Titles

- Title XV – Miscellaneous Provisions
 - Restrictions on the use of US funds for foreign Governments; protection of American taxpayers
- Title XVI – Section 1256 Contracts
 - Certain swaps not treated as section 1256 contracts
 - Interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement




Are You Ready?

- What do Compliance Officers and Internal Audit departments need to do to get ready for the Act?
- What role will Compliance Officers play in the new banking landscape?



It's a Team Effort

- Team effort required across all divisions of the bank
 - Compliance Officer
 - Internal Audit
 - Line Managers (Business Development)
 - Executive Management
 - Audit and Risk Committees
 - All bank personnel to insure that any deficiencies noted are properly and timely remediated



Internal Audit and Compliance Officer's Role

- Internal audit is an integral part of the bank to ensure compliance with the new laws and regulations, and disclosure and reporting requirements imposed by the Dodd-Frank Act.
- Start with an internal audit risk assessment to effectively manage the resources of the internal audit department



Internal Audit and Compliance Officer's Role

- Compliance Officer's need to work with Internal Audit to develop an annual enterprise risk assessment to effectively capture and score relevant risk factors
- Annual audit plan development to ensure coverage of all significant risks, operations and activities with appropriate scope and frequency
- Flexibility to incorporate changes in scope



Internal Audit and Compliance Officer's Role

- Properly budget for the increased cost to the internal audit department to train staff on changes imposed by the Dodd-Frank Act and updates to the audit universe and audit programs as necessary
 - Increased cost of deposits due to competitive market and reduction in non-interest income will cause banks to search for ways to reduce other expenses.
 - Many banks cut staff to reduce overhead. Such cutbacks may increase the risk to the institution. This risk can be mitigated by increasing the frequency of internal audit review for the impacted areas.



Line Managers/Business Development

- Train line management when the new rules and regulations are implemented
- Communication in planning, conducting, reporting, and follow up of audits
 - Incorporate management's concerns into audit steps
 - Immediately alert management of significant issues
 - Discuss possible management action plans to rectify noted issue
 - Interaction with management through implementation of remediation plan



Executive Management

- Executive management needs to be aware of the changes imposed by the Act
 - Active involvement in the risk assessment and audit plan development
 - Kept abreast of significant issues as they materialize
 - Gain their support of the remediation plan as it may be a significant cost to the bank in time and/or dollars



Audit/Risk Committees

- Communication of internal audit issues to audit/risk committee(s)
 - Chief Audit Executive periodic presentation to the audit/risk committee
 - Discuss in detail the scope of work performed for the audit area
 - Issues noted and the associate risk
 - Management's action plan to remediate



Audit/Risk Committees

- Audit/Risk committee(s) needs to track the timely resolution of issues noted.
 - Add follow up audits as deemed necessary
 - Alter the audit plan as changes develop



Conclusion

- Don't panic
- A lot of uncertainty still remains
- Changes will come over the next few years and not all at once
- Remain proactive and not reactive
- QUESTIONS??



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