

Overview of the Administration's Plan

The Administration's financial reform plan, announced on June 17, is intended to restore confidence in the integrity of the U.S. and global financial system. In announcing the Plan, President Obama emphasized that the proposed reforms are an attempt to build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.

The Plan, which the President wants to complete this year, centers on expanding the power of the Federal Reserve to police large, systemically important institutions, allowing the government to break firms apart, implementing new rules for complex instruments and creating a new federal agency to oversee consumer products such as mortgages and credit cards.

The Plan will touch almost every corner of financial markets, from tougher consumer-protection policies to stricter rules over exotic financial products, such as credit derivatives. The Plan would bring many of the products and companies that previously operated outside of the banking system under federal scrutiny. The Administration's Proposal would give the government the power to take over and wind down a large financial company, a power that government officials lacked last year when the financial crisis was intensifying. It would also give the central bank more powers over the payments and settlements systems in U.S. financial markets to prevent a breakdown that officials fear could destabilize the economy.

The Plan proposes reforms to meet the following five key objectives:

1. Promote robust supervision and regulation of financial firms.
2. Establish comprehensive regulation of financial markets.
3. Protect consumer and investors from financial abuse.
4. Provide the government with the tools it needs to manage financial crises.
5. Raise international regulatory standards and improve international cooperation.

Promote robust supervision and regulation of financial firms

Existing regulation focuses on the safety and soundness of individual institutions but not the stability of the system as a whole. As a result, institutions were not required to maintain sufficient capital or liquidity to keep them safe in times of system-wide stress. In a world in which the troubles of a few large firms can put the entire system at risk, that approach is insufficient.

The administration's proposal will address that problem by raising capital and liquidity requirements for all institutions, with more stringent requirements for the largest and most interconnected firms. In addition, all large, interconnected firms whose failure could threaten the stability of the system will be subject to consolidated supervision by the Federal Reserve. Further, a council of financial services regulators will be established with broader coordinating responsibility across the financial system.

The Administration proposes:

- A new Financial Services Oversight Council of financial regulators to identify emerging systemic risks and improve interagency cooperation.
- New authority for the Federal Reserve to supervise all firms that could pose a threat to financial stability, even those that do not own banks.
- Stronger capital and other prudential standards for all financial firms, and even higher standards for large, interconnected firms.
- A new National Bank Supervisor to supervise all federally chartered banks.
- Elimination of the federal thrift charter and the Office of Thrift Supervision and other loopholes that allowed some depository institutions to avoid bank holding company regulation by the Federal Reserve.
- The registration of advisers of hedge funds and other private pools of capital with the SEC.

Establish comprehensive regulation of financial markets

The structure of the financial system has shifted, with dramatic growth in financial activity outside the traditional banking system, such as in the market for asset-backed securities. In theory, securitization should serve to reduce credit risk by spreading it more widely. But by breaking the direct link between borrowers and lenders, securitization led to an erosion of lending standards, resulting in a market failure that fed the housing boom and deepened the housing bust.

The Administration's Plan will impose robust reporting requirements on the issuers of asset-backed securities; reduce investors' and regulators' reliance on credit-rating agencies; and, perhaps most significant, require the originator, sponsor or broker of a securitization to retain a financial interest in its performance. The Plan also calls for harmonizing the regulation of futures and securities, and for more robust safeguards of payment and settlement systems and strong oversight of "over the counter" derivatives. All derivatives contracts will be subject to regulation, all derivatives dealers subject to supervision, and regulators will be empowered to enforce rules against manipulation and abuse.

The Administration proposes:

- Enhanced regulation of securitization markets, including new requirements for market transparency, stronger regulation of credit rating agencies, and a requirement that issuers and originators retain a financial interest in securitized loans.
- Comprehensive regulation of all over-the-counter derivatives.
- New authority for the Federal Reserve to oversee payment, clearing, and settlement systems.

Protect consumers and investors from financial abuse

The current regulatory regime does not offer adequate protections to consumers and investors. Weak consumer protections against subprime mortgage lending bear significant responsibility for the financial crisis. The crisis, in turn, revealed the inadequacy of consumer protections across a wide range of financial products -- from credit cards to annuities. Building on the recent measures taken to fight predatory lending and unfair practices in the credit card industry, the

administration will offer a stronger framework for consumer and investor protection across the board.

The Administration proposes:

- A new Consumer Financial Protection Agency to protect consumers across the financial sector from unfair, deceptive, and abusive practices.
- Stronger regulations to improve the transparency, fairness, and appropriateness of consumer and investor products and services.
- A level playing field and higher standards for providers of consumer financial products and services, whether or not they are part of a bank.
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Provide the government with the tools it needs to manage financial crises

The federal government presently does not have the tools it needs to contain and manage financial crises. Relying on the Federal Reserve's lending authority to avert the disorderly failure of nonbank financial firms, while essential in this crisis, is not an appropriate or effective solution in the long term. To address this problem, the Plan will establish a resolution mechanism that allows for the orderly resolution of any financial holding company whose failure might threaten the stability of the financial system. This authority will be available only in extraordinary circumstances, but it will help ensure that the government is no longer forced to choose between bailouts and financial collapse.

The Administration proposes:

- Revisions to the Federal Reserve's emergency lending authority to improve accountability. A new regime to resolve nonbank financial institutions whose failure could have serious systemic effects.
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Raise international regulatory standards and improve international cooperation

Finally, in recognition of the globalized financial system, the Administration will lead the effort to improve regulation and supervision around the world.

The Administration proposes:

- International reforms to support domestic efforts, including strengthening the bank international capital framework; improving oversight of global financial markets; coordinating supervision of internationally active firms; and enhancing crisis management tools.

Areas of Concern for NAHB

NAHB Staff are presently combing through the Plan to identify key areas of concern for NAHB. Some initial possible areas of concern are outlined below. This list will be refined based on further review of the Administration's proposal.

Elimination of thrift charter and OTS – NAHB policy supports a specific charter for institutions specializing in housing finance (thrift charter) and a housing finance focus in any future bank regulatory structure.

Future Role of the GSEs – Plan requires that Treasury and HUD include a plan for the future of the housing government-sponsored enterprises (GSEs) in the President's 2011 Budget Proposal. The white paper lists several possible structures, but omits a cooperative structure (similar to that of the Federal Home Loan Bank System) which NAHB supports.

Reassessment of Capital Requirements – A Treasury working group is directed to reassess the existing bank capital framework by December 31. The Plan also calls for capital requirements for all financial firms, not only banks. Additionally, higher capital requirements will be imposed on systemic firms. This is all likely to lead to higher capital requirements, particularly for mortgages and housing production loans, which have borne the brunt of the blame for the current economic crisis.

Mortgage Lending Reforms – Requires mortgage originators to retain 5 percent of the credit risk on mortgages they securitize. This is similar to the mortgage lending reform bill (H.R. 1728) which passed the House in early May. NAHB opposed this provision due to concerns that it will raise mortgage costs and reduce mortgage innovation.

Consumer Financial Protection Agency – The CFPA will take over enforcement of major consumer protection laws, including Truth-in-Lending, Truth-in-Savings, HOEPA and RESPA, which are presently under the purview of the banking regulators and HUD. Further, the Plan does not provide for pre-emption of state laws (which OCC and OTS can presently do for national institutions) which will allow states to enforce stronger consumer protection laws. This will add another layer of regulation, making it more expensive for banks to offer products and services to borrowers.

Reduced Government Support to the Mortgage Market – The combination of all these factors opens the door for reduced government support to the mortgage markets. NAHB supports continued government support to the primary and secondary mortgage markets in order to ensure available and affordable mortgage credit in all geographic areas and under all economic circumstances.