

June 25, 2010

TO: Bank CEOs

FROM: Art Johnson, ABA Chairman, and Ed Yingling, ABA President and CEO

RE: Report to Members on Financial Reform

The conference report on the massive financial reform bill has now been agreed to by the conferees. It is expected to move to the House floor next week and the Senate soon thereafter. There is no way to cover this massive bill in a short memo, but we wanted to give bankers a perspective on how we got here and where we are headed.

First, let us express our great appreciation to the thousands of bankers across the country who were involved in our grassroots efforts. While you are justifiably frustrated with the Congress and the outcome, please know that you made a huge difference.

Second, we thank all the state associations for their tremendous work. Throughout this more than year-long process, the leaders of the state associations worked daily on issue after issue to deliver a unified message and to discuss our positions with their state Congressional delegations. And we spent countless hours with the media, explaining issues and fighting misconceptions. The consistent message and strategy of the ABA-state association alliance is a model of how our industry should work together.

We will continue to oppose this bill on the House and Senate floors, but this is not the end of the process. There never is an end in Washington. In the next Congress, no matter how difficult it may be, we will be moving aggressively to try to fix problems in this legislation. Our large and experienced regulatory team will be working, in coordination with the states, on the steady stream of regulations that will result from this bill. Finally, beginning with a soon-to-be-released comprehensive summary of the bill, ABA will be providing all our members with detailed information on the regulations as they are rolled out, including tools to help you comply.

How We Got Here

By the fall of 2008, it was very clear that our industry was going to face a massive piece of legislation under the most difficult political circumstances. As we have previously stated, four

forces came together at one time: first, the deepest recession since the Great Depression, and one that grew worse because of problems in the financial system; second, the TARP capital program led to charges, generally mis-reported in the media, of a “bailout,” to which the public reacted very negatively; third, a new, highly partisan Congress was elected; and fourth, a new President was elected who had the support of, and remained close to, consumer and community groups. The last two forces insured that we would not only face comprehensive financial reform legislation, but that a very large “consumerist” agenda would be added to it as well. In addition to regulatory reform and consumer issues, we also knew that other groups would attempt to use this process -- and the fact that our industry would be spread thin working on so many issues -- to push their own self-serving proposals, including mortgage cram-down, credit union expansion, and, of course, interchange limits. We set our legislative strategy accordingly.

Given the strong Democratic majority, we expected the House to pass a bill that largely reflected the Administration’s proposal. We were able, nevertheless, to make a number of improvements to the bill in the House and to defeat negative amendments, such as the mortgage cram-down amendment offered on the House floor. The bill passed the House by a narrow 223 to 202 majority. Among the improvements we made in the House: the elimination of the authority of the new Consumer Financial Protection Agency (CFPA) over CRA and to design mandated “plain vanilla” products; improvements in the language that eliminated preemption; a partial exemption for banks under \$10 billion from examinations by the CFPA; protection of the thrift charter, which had been proposed for elimination; adding a mandate for bank regulators to look at FASB proposals and publicly comment on them; and an exemption for small banks from Section 404 of Sarbanes-Oxley.

The bill then went to the Senate, where we thought we could make further improvements, both because of the makeup of the Senate and because its rules give more negotiating power to the minority. At the beginning of this year, after the election in Massachusetts gave the Republicans 41 votes, it looked like we were headed for an improved, negotiated bill that would significantly limit the CFPA’s powers and contain no additional negative amendments. Unfortunately, the dynamic in the Senate then changed dramatically for three reasons: first, the passage of health care emboldened the Administration and its congressional allies to push, with little compromise, their high priority issues and to force passage even over strong opposition; second, after the high-profile SEC charges against Goldman Sachs, proponents of the legislation used the media effectively to label this a “Wall Street” bill; and third, regrettably our industry sent a mixed message at the critical point in the debate.

On the latter point, ABA, the state associations, and thousands of bankers supported the efforts of Senators who wanted to stop the bill from coming to the floor without a bipartisan agreement -- one that would both address a number of our high-priority concerns and, importantly, prevent negative amendments from being added on the floor. We all worked hard to force such an agreement and were successful on three separate votes against cloture on the Senate floor. However, ICBA (which had also supported the bill in the House) had a different

strategy and supported the efforts of Senate proponents of the bill to obtain cloture without any agreement. Because there was no negotiated agreement, we had to spend political resources on the Senate floor and in conference for amendments that would have been in the agreement. Even worse, the Collins and Durbin amendments, which would certainly not have been part of the agreement, were passed. Allowing this bill to go to the floor and be subjected to over 300 filed amendments, many of them negative, in this terrible political atmosphere was something ABA and all the state associations tried hard to prevent. We will work for unity in our message as the conference report goes to the House and Senate floors.

Priority Issues

The ABA, in coordination with the state associations, worked on dozens and dozens of issues. Bankers were not even aware of many of these – amendments floated but never offered, amendments withdrawn, provisions worked out behind the scenes. But many of the issues – in the original Administration proposal or in amendments offered during the Congressional process – required more visible efforts. Below is a very brief summary of those issues.

Positive reforms:

- As ABA had advocated from the beginning, a systemic risk council was created, although we find the structure to be unnecessarily complex.
- In perhaps the most important reform, a mechanism for the resolution of the failures of systemic entities was created, very similar to what ABA had proposed to avoid future questions on how to resolve a Lehman or AIG and to address too-big-to-fail.
- Important regulations and regulatory oversight will be applied to entities outside traditional banking, from Wall Street to mortgage brokers; however, unfair exemptions and loopholes are included.
- Provisions advocated by ABA were added during the process, including mandating that the systemic oversight council review accounting proposals, exempting small banks from Section 404 of Sarbanes-Oxley, and permanently increasing deposit insurance to \$250,000 (although at the cost of removing governing limits on how large the BIF can grow); most banks will be pleased that the prohibition on payment of interest on corporate demand deposits is repealed one year after the bill is signed.

Proposals defeated or stopped:

- The Administration proposals to give the new consumer agency authority over CRA and to mandate the offering of government-designed “plain vanilla” products were stripped from the bill.
- The Administration proposal to eliminate the thrift charter was removed.
- The Dodd language to remove the Fed’s authority to regulate state member banks was taken out.
- A House floor amendment to impose a cram-down on mortgage loans was defeated.

- Language that would have imposed national bank lending limits on state chartered banks was removed.
- Various provisions that would have significantly harmed the Federal Home Loan Banks were removed.
- A Senate amendment that would have encouraged states to enact usury ceilings was defeated.
- A Senate amendment to cap ATM fees was not offered.
- The Administration proposal to require extensive new reporting on deposits was removed.

Negative Provisions: The bill contains a number of very negative provisions. In almost every case, we were able to modify these provisions, but they still are negative.

- The consumer protection agency was changed considerably, with its powers cut back, a review system (although a weak one) including bank regulators added, and authority for prudential regulators to conduct the exams (with some exceptions) for banks under \$10 billion included. However, this remains an incredibly powerful agency that will impose heavy new regulations that, in some cases, will conflict with safety and soundness.
- The Durbin debit card interchange amendment was improved, but only very modestly, and will harm consumers and result in a very significant loss of revenue for banks of all sizes. In addition, the precedent has been set for applying price controls to bank products.
- While a number of new regulatory proposals were removed or defeated, numerous new reporting and regulatory requirements are included in the bill, such as expanded HMDA reporting and new reporting requirements on small business loans.
- Although we worked successfully to remove several provisions that would increase litigation risk, others remain in the bill.
- We obtained a number of improvements to the FDIC-supported Collins amendment on capital, including grandfathering all trust preferreds for banks under \$15 billion and obtaining a phase-down for others; however, the remaining restrictions will be a problem for many banks and will restrict the ability of banks to expand lending.
- Although a number of improvements we advocated were made to the risk retention – or “skin-in-the-game” – provisions, the final version will limit the ability of banks to make loans.
- We also significantly improved the original Administration proposal to eliminate federal preemption, a proposal which would have led to an avalanche of new state and local laws that would have confused consumers and driven up the cost of providing bank services. However, the final preemption provisions will still cause problems.
- Improvements were made to the various derivatives proposals, including the draconian one authored by Senator Lincoln that would have hurt banks of all sizes and their customers. Still, the final version goes too far and hurts the ability of banks to efficiently provide hedging for their customers.

Needed Reform Gone Bad

As ABA and the state associations said from the beginning of this process early last year, reform is needed. We supported many of the core reforms that are contained in the conference report. However, despite a lot of rhetoric from legislators and the Administration about their concerns for traditional banks, in the end, bankers across the country and state associations agree: this is a bad bill for banks, their communities, and the economy. (Interestingly, the credit union industry also opposes the bill for many of the same reasons.) Parts of the bill affect some banks differently than others – e.g., most banks will pay lower FDIC premiums while a minority will pay more, and some restrictions apply only to banks of a certain size or profile. But every banker we talk to opposes the bill.

In the end, the fundamental questions for our elected officials are these: If traditional banks, as those officials often stated, did not cause the crisis and are needed to support our troubled economy, why are these banks being hit with such onerous new burdens and restrictions? If you support community banking, why are you enacting a bill and creating a regulatory environment that are going to drive many smaller banks to sell purely because of the regulatory burden? If you are supposed to be creating a new, internationally coordinated regulatory regime, why are you imposing burdens (think bank tax, for example) on our banks that, in many cases, go beyond what other countries are going to do? And, finally, if you want economic growth, why would you enact provisions on capital, lending restrictions, bank income opportunities, and regulatory burdens that clearly will dramatically decrease the ability of banks to lend?

This is why ABA and the state associations have consistently opposed this bill. The battle for our industry's future, for the future of our communities, and for economic growth, is not over. The rule-writing process will be very important. And we will insist that the next Congress revisit the problems created by this legislation. More than ever, bankers need to be involved in the political process.

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