Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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The Dangers of the Current Regulatory Mass[*]

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May, 2011

Regulators have layered massive amounts of proposed regulations on the public since the passage of the Dodd-Frank Act last year. In the mortgage industry, that was exacerbated by the periodic review of Regulation Z, a task the Board completed during the last year or so (some portions of which it then deferred implementing). In doing so, the regulators have strained the ability of consumers and the industry to provide thoughtful comments that can be useful in the regulator's finalization of the rules, as well as imposed major burdens on the individual staff of the regulators. No good answer has been proposed on how the crush can be best addressed, but it seems clear that trying to do this much in a short period of time will create mistakes and problems.

During the past two or three years, the federal regulators have issued well over 50 major proposed rules on mortgages and related matters. The number of pages that the narrative and the rules themselves cover is stunning. The last two, that related to risk retention and that related to the rules covering ability to repay a loan, cover over 800 pages of text, and in the text of the risk retention rule are embedded 174 detailed questions for which the agencies have solicited comments. Earlier proposals on mortgage disclosure, or the regulation of HUD's relative to the new GFE, were similarly massive. Discussions with HUD over the ambiguities in its proposal generated well over 150 serious questions for HUD to address from one trade association alone. Forms and systems are being modified, modified again, and modified again and again, seemingly endlessly.

The regulators, in turn, have been crushed with the number of regulations they must promulgate under the Dodd-Frank Act, the speed with which they must do that, and the complexity of the issues surrounding them. Congress left a lot of unanswered questions for the regulators to address when they drafted the Dodd-Frank Act. If that were not enough, they

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included in that Act entirely new concepts in both the statutory scheme and the regulatory structure to address the scheme.

Choosing which of all of these creates the most immediate problem depends upon your profit center, of course. What is happening in the derivatives world is industry-change of a major sort. What is happening in capital at both the country and global levels is likewise institution-changing. Choosing what non-banks meet the standards to be a SIFI presents novel and difficult intellectual decisions. Assembling the data to provide guidance to those on the Financial Oversight Council will task all of the researchers to the limit, and the slow start of the Office of Financial Research doesn't help. How to resolve major failures remains a daunting job, although frankly, that is not a regulatory task that regulators should place on the front burner since that won't be tested for decades (similarly with concepts of living wills, concepts which have been commented upon before in these letters (See, ***"Living Wills May Kill You,"*** Our Perspectives, Issue No. 4, August 2010).

In many respects, however, the creation of the Consumer Financial Protection Bureau creates more complications than any of the others. The leading choice of the Administration for the position of Director of the Bureau does not seem to have gathered sufficient support in the Senate to be confirmed, and the Administration has not yet announced a decision (if in fact it has made a decision) to make a recess appointment to that post. Not only would a recess appointment bypass the Appointments Clause of the constitution and anger the Senate, the term of the appointee would be limited to the remainder of this Congress. Questions linger, therefore, over what the role of the Bureau will become when the responsibility and authority for providing certain supervisory and regulatory tasks transfers to that Bureau on the Designated Transfer Date. That is currently scheduled for July 21, but the Secretary of the Treasury can move that back six months if he chooses to do so.

Absent a Director and clear guidance on the schedule and agenda going forward for that Bureau, the other agencies are put in difficult positions. For example, the Board of Governors has the responsibility of drafting regulations that will govern the ability to repay rules in the DFA. While that responsibility terminates at the date of the Designated Transfer Date, it currently rests with the Board. Since the DFA imposed upon the regulators a requirement to promulgate a joint regulation implementing the risk retention rules in final form by April 27 of this year, and since there is a direct and crucial link between the two regulations (the QRM in the risk retention rule cannot be broader than the QM in the ability to repay provisions), the Board proposed the rule for the QM rule while the QRM rule was still awaiting comments, not withstanding that it recognized that it would not be making the final decisions on what might be in the final rule. That would be the responsibility of the new CFPB after July 21. The Board, therefore, asked for comments by July 22, the day after the current Designated Transfer Date.

What happens on July 22 remains fuzzy at this time, notwithstanding that it is clear that the Administration will assume that the Secretary may assume those authorities transferred to CFPB on the Designated Transfer Date. In the meantime, employees are being seconded to the Bureau, and some are being hired, thereby removing that resource from the agency from which they are transferring.

From the perspective of the promulgation of rules, the complicated posture of the CFPB provides uncomfortable background noise to the complexity of the lengthy proposals and their central position in the question of whether or not the housing market has a robust or anemic recovery. So, the problems surrounding the CFPB are probably as serious as any issues in the implementation of DFA.

Risk retention is complicated by a variety of issues in the proposal, one of which is the refusal to accept that the use of mortgage insurance is an acceptable way to minimize risk. Risk-free loans, QRM loans, may not make use of mortgage insurance to meet LTV standards, for example. The agencies recognize the fact that this might be problematic, and propose an alternative that does permit some recognition of mortgage insurance. The proposal also layers on a second risk retention requirement by refusing to endorse the long-standing practice of monetizing certain profits and fees at the front end of the securitization, thereby putting at risk a major established practice of the market. Finally, the proposal provides yet another class action weapon for plaintiffs to use by placing servicing standards in the mortgage documents instead of holding off on that and looking to the uniform mortgage servicing standards the agencies currently have in process instead.

Efforts to address these industry-changing proposals in this one rule are absorbing hundreds of hours in the industry, and most likely lengthy consideration in non-industry segments of the economy as that segment also has recognized the danger in promulgating rules that will either delay or in fact hinder the development of a robust housing sector. For example, the premium capture cash reserve account proposed rule introduces an entirely new consideration for respondents to reflect upon. There was never a signal from Congress, at any time during the lengthy period leading to final passage of the bill, that the industry should abandon a key practice that is consumer friendly, and treat it as an additional risk for which it would have to retain the risk of first loss.

Comparable concerns exist in all aspects of Dodd-Frank Act regulations, and even greater number of hours may be needed in some of the other areas. The CFTC, for example, had 31 proposals or concept releases out for public comment in late December of 2010 (See Davis Polk's ***"Dodd-Frank Rulemaking Progress Report,"*** May 2, 2011).The risk of the pressurized production of this mass of rules throughout the residential mortgage industry producing unintended results are sufficiently high as to create unintended results inevitably, as they are in derivatives, SIFI creation, capital issues, resolution, or any of the other issues surrounding the Dodd-Frank Act, or in the important issues surrounding non-Dodd-Frank Act regulations that are swept up in this mass of regulations. If there is any solution it is for the agencies to utilize a systematic approach that reviews simultaneously like kinds of issues generated by different provisions, and do so through a stretched out and published schedule for doing so.

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