X. FDIC Reforms and Initiatives Under Dodd-Frank

A. Introduction

Following the 2007-2008 financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") assigned significant responsibility to the Federal Deposit Insurance Corporation ("FDIC") for writing and implementing new rules on financial regulatory reform.[1] The FDIC's role under Dodd-Frank stems from the primary purposes of the Act: ending "Too Big to Fail," minimizing moral hazard, and mitigating systemic risk.[2] Dodd-Frank tasked the FDIC with implementing 44 new regulations, including 26 joint rulemakings and 18 independent rulemakings.[3] Of these tasks, some of the most significant assignments for the FDIC include: (1) strengthening and reforming the deposit insurance fund; (2) strengthening capital requirements; (3) creating risk retention rules for asset backed securities; and (4) adopting rules with other federal banking agencies to curtail incentive based compensation.[4] This article will present background on these initiatives, discuss the FDIC's implementation of rules pursuant to each initiative, and examine possible effects of each initiative.

B. The Deposit Insurance Fund

As of February 18, 2011, the year's total number of bank failures reached 28.[5] In 2010, 157 banks failed and in 2009, 140 banks failed.[6] The costs associated with bank failures are largely

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[1] *See, e.g., FDIC Staff Summary of Certain Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act,* http://www.fdic.gov/regulations/reform/summary.html (describing Dodd-Frank initiatives that concern the FDIC).
[2] *FDIC Chair Describes New Resolution Authority*, 29 AM. BANKR. INST. J. 10, 73 (2010) (stating the primary purposes of Dodd-Frank).
[3] *See Oversight of Dodd-Frank Implementation: A Progress Report by the Regulators at the Half-Year Mark: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs,* 112th Cong. (2011) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation).
[4] *See id.*
[5] Federal Deposit Insurance Corporation, *Failed Bank List*, *available at* http://www.fdic.gov/bank/individual/failed/banklist.html.
[6] *Id.*

born by the Deposit Insurance Fund (DIF).[7] Such failures place a strain on the DIF, which thousands of banks support through quarterly premium assessments.[8]

The FDIC relies on premium fees collected from banks that fund the DIF in order to pay off depositors in the event of a bank failure; however, during 2009 and 2010 the DIF's balance and reserve ratio became negative, preventing the FDIC from relying on premiums to pay off depositors.[9] As a result, during the financial crisis, the FDIC took measures to protect the DIF through a special assessment on insured banks and by requiring a three-year prepayment of premiums by insured banks into the DIF in the amount of $45 billion.[10]

Prior to reforms passed in 2006, the FDIC was prevented by statute from building up the DIF during favorable economic times to help it withstand losses during economic downturns without drastically increasing premiums.[11] In 2006, Congress passed reforms that permitted the FDIC to charge banks a risk-based premium and provided the FDIC limited authority to manage the size of the DIF.[12] The FDIC changed its premium pricing rules accordingly, however, the financial crisis prevented the FDIC from building up the DIF balance.[13]

Dodd-Frank revised the statutes governing the FDIC's management of the DIF, providing the FDIC with the ability to maintain a positive fund balance while sustaining balanced assessment rates during volatile economic and credit cycles, even in

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[7] *Cf.* Federal Deposit Corporation, *FDIC Key Statistics*, http://www2.fdic.gov/idasp (stating that as of February 17, 2011, the FDIC insured 7,635 depository institutions through the DIF).

[8] *See* Eric Dash, *As Bank Failures Rise, F.D.I.C. Fund Falls Into Red,* N.Y. TIMES, Nov. 24, 2010, at B4 (explaining that the DIF has sustained significant losses as a result of a large number of bank failures).

[9] *Cf.* Ronald D. Orol, *FDIC Starts To Replenish The Bank Insurance Fund,* MARKETWATCH, Oct. 19, 2010, http://www.marketwatch.com/story/fdic-starts-plan-to-replenish-bank-insurance-fund-2010-10-19 (reporting on FDIC's plan to return the reserve ratio to 1.35% of U.S. insured deposits by September 30, 2020).

[10] Alison Vekshin Bloomberg, *Banks To Prepay $45 Billion Into FDIC Fund; Large Number of Failures Has Drained Regulator's Safety Net*, SUN SENTINEL, Nov. 13, 2009, at 1D.

[11] *Supra* note 3.

[12] *Id.*

[13] *Id.*

the midst of a banking crisis.[14] Specifically, Dodd-Frank raised the minimum Designated Reserve Ratio (DRR)—representing the amount of cash the FDIC has on hand to satisfy depositors in the event of a bank failure in relation to the total amount of federally insured deposits—from 1.15 percent to 1.35 percent and relieved the FDIC from paying dividends when the reserve ratio rises above 1.50 percent, in addition to other changes.[15]

In December 2010 and February 2011, the FDIC Board of Directors completed two rulemakings pursuant to Dodd-Frank relating to its strategy for DIF management and attainment of the 1.35 percent DIF reserve ratio: enacting assessment rates that will take effect on April 1, 2011 and enacting lower rates that will trigger when the DIF reserve ratio reaches 1.15 percent.[16] In addition, on January 1, 2011, the FDIC amended its regulations to set the DRR at 2 percent.[17]

The DIF reforms focus on the DRR and the dividend rule because FDIC analysis revealed that these were among the most important factors in maximizing the probability that the DIF will remain positive during times of crisis and in counteracting dramatic increases in premium assessments during a crisis.[18] The FDIC believes such modifications to the reserve ratio and dividend policy will permit DIF growth to a level sufficient to ensure that fund reserve ratios will withstand a future crisis, while at the same time maintaining balanced and predictable assessment rates.[19]

Dodd-Frank also directed the FDIC to change the base on which deposit insurance assessments are charged from a system based on domestic deposits to one based on average total consolidated assets minus average tangible equity.[20] Although the FDIC does not anticipate that the change to a new assessment base

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[14] *See* Assessments, Large Bank Pricing, 76 Fed. Reg. 10672, 10674 (Feb. 25, 2011) (to be codified at 12 C.F.R. pt. 327) (stating that, in accordance with Dodd-Frank's mandates, the FDIC has taken steps to reduce the pro-cyclicality of DIF assessments and to maintain a positive fund balance even during an economic disruption).

[15] *Supra* note 3. The Federal Deposit Insurance Act defines the term "reserve ratio" as "the ratio of the net worth of the Deposit Insurance Fund to the value of the aggregate estimated insured deposits." 12 U.S.C. § 1813.

[16] *Supra* note 3.

[17] *Supra* note 14, at 8.

[18] *Supra* note 3.

[19] *Id.*

[20] *See supra* note 1.

will result in higher assessments for all large institutions,[21] the change will move the overall assessment burden away from smaller community banks and closer toward the largest institutions (which are less dependent on domestic deposits than are smaller institutions).[22] Under the new system, many large institutions will experience significant changes in their overall assessments due to the interaction of the expanded assessment base and the increased risk differentiation among large banks.[23] According to the FDIC, the combined effect of DIF rule changes on large institutions will result in 59 institutions paying lower assessments and 51 institutions paying higher assessments; while the overwhelming majority of small institutions will pay 30 percent less in assessments under the new system as a result of the change in the assessment base.[24]

C. Capital Requirements

Dodd-Frank mandates new capital requirements under the so-called "Collins Amendment" for financial companies and other companies believed to pose systemic risk.[25] The FDIC is among the federal regulators tasked with implementing new capital requirements, and the agency believes the Collins amendment will go further than any other portion of Dodd-Frank toward improving U.S. bank capital.[26] The goals of the Collins Amendment are to make certain that financial institutions hold sufficient capital to absorb losses during future periods of financial distress, to prevent "shopping" for more favorable treatment among regulators, and to prevent accumulation of excessive leverage during a financial crisis by large nonbank financial institutions.[27]

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[21] *See supra* note 14, at 110.
[22] *Supra* note 3.
[23] *Id.*
[24] *Id.*
[25] Arnold & Porter LLP, *Dodd-Frank Act Mandates Stricter Capital Requirements for Financial Institutions,* July 2010, http://www.arnoldporter.com/resources/documents/Advisory--Dodd-Frank_Act_Mandates_Stricter_Capital_Requirements_071610.pdf (discussing Dodd-Frank, including the Collins Amendment).
[26] *Supra* note 3.
[27] *See* Michael B. Mierzewski, Howard L. Hyde, Beth S. DeSimone, & Wasim W. Quadir, *Stricter Capital Requirements Mandated for Financial Institutions,* 127 BANKING L. J. 742, 743 (2010) (citing Letter by Sheila Bair to Sen. Collins, Cong. Rec. S.3460 (May 10, 2010)).

Regulatory capital requirements have always held a high priority among financial regulatory concerns; however, the deluge of bank failures following the financial crisis resulted in an increased emphasis on capital.[28] The new capital requirements provide significant changes for determining regulatory capital, the likely result being that many companies will be forced to raise additional capital.[29] In her February 17, 2011 address to the Senate Banking Committee, FDIC Chairman Sheila C. Bair described the significance of the new emphasis on regulatory capital, stating that:

> [I]n the years before the crisis, U.S. regulators were embarking down a path that would allow the largest banks to use their own internal models to set, in effect, their own risk-based capital requirements, commonly referred to as the "Basel II Advanced Approach." The premise of the Advanced Approach was that the largest banks, because of their sophisticated internal-risk models and superior diversification, simply did not need as much capital in relative terms as smaller banks. The crisis demonstrated the fallacy of this thinking as the models produced results that proved to be grossly optimistic . . . The Collins Amendment assures that whatever advances in risk modeling may come to pass, they will not be used to allow the largest banks to operate with less capital than our nation's Main Street banks.[30]

Under Dodd-Frank § 171, the generally applicable capital requirements that apply to the smallest banks will operate as a floor for the capital requirements of the largest banks, including bank holding companies and nonbanks supervised by the Board of Governors of the Federal Reserve System ("FRB").[31] In essence, Dodd-Frank requires regulators, including the FDIC, to apply the same capital and risk standards to systemically important financial companies as are currently applied to FDIC insured banks.[32] Under the new rules, hybrid capital instruments, including trust preferred

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[28] *Id.* at 747.
[29] *Id.*
[30] *Supra* note 3.
[31] *See supra* note 1.
[32] *Supra* note 27, at 743.

securities, will no longer be included in the definition of Tier 1 Capital, resulting in a deterioration of the capital cushions of bank holding companies that depended on trust preferred securities to meet capital requirements.[33] Such companies must now issue other forms of Tier 1 Capital such as perpetual non-cumulative preferred stock to remain in compliance with the new capital requirements.[34]

Some banking industry experts believe that banks will respond to the new rules by raising the costs of most loan products including mortgages, corporate loans, and credit cards. [35] Banks subject to the new capital rules will raise lending costs, these experts argue, because in order to meet the new requirements, banks must retain a larger portion of cash on their books, which will, in turn, drive revenues down, and in response banks are already seeking ways to increase the amounts charged on loan products.[36]

D. Risk Retention for Asset Backed Securities

Asset-backed securities represent one of the largest sources of credit losses and write-downs at large financial companies since the onset of the financial crisis,[37] and although lenders currently exhibit a position of risk aversion toward the markets, the FDIC has expressed that as this risk aversion begins to wear off and lending begins to pick up, there will be a need to ensure that underwriting standards do not return to the misguided practices that led to the financial crisis.[38] On May 11, 2010, the FDIC voted to seek comment on a rule requiring issuers of asset backed securities to retain five percent of the credit risk associated with such securities (while proposing a safe-harbor for investors in such securities).[39] Subsequently, Dodd-Frank mandated that the FDIC, in cooperation with the FRB, the Office of the Comptroller of the Currency

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[33] *Id.*
[34] *Id.,* at 744.
[35] Heidi N. Moore, *Capital Rules,* N.Y. TIMES, Nov. 23, 2010, at B8.
[36] *Id.*
[37] Phil Mattingly, *FDIC Advances Securitization, Bank 'Funeral' Measures (Update1)*, BLOOMBERG, May 11, 2010, http://www.businessweek.com/news/2010-05-11/fdic-advances-securitization-bank-funeral-measures-update1-.html.
[38] *Supra* note 3.
[39] *Id*.

("OCC"), and the Securities and Exchange Commission ("SEC"), issue rules on risk retention by April 17, 2011.[40]

Pursuant to its mandate under Dodd-Frank, the Financial Stability Oversight Council ("FSOC") delivered a study to Congress on January 18, 2011 that explores how risk retention rules can help reform the securitization market.[41] The study concludes that: (1) although securitization is vital to credit formation, the risks inherent in modern securitization practices contributed to the financial crisis; (2) proper securitization structures can counter these risks through appropriate issuer risk retention; and (3) risk retention can lead to better lending practices which "may help to mitigate some of the pro-cyclical effects securitization may have on the economy."[42] The study also discusses three possible forms of risk retention, including: (1) a five percent pro rata retention of each tranche issued; (2) retention of a five percent first loss position in each securitization; and (3) retention of five percent of all assets conveyed to the issuing entity.[43]

Mortgage industry executives who commented on the proposed risk retention framework argue that while the new rules are necessary, they may wind up unduly limiting the availability of traditionally safe mortgages to all U.S. consumers.[44] As a result, a bipartisan group of legislators incorporated a provision into the proposed legislation specifying that mortgages meeting certain standard criteria, entitled "Qualifying Residential Mortgages" ("QRMs") would be exempt from the five percent risk retention rules.[45] Dodd-Frank Section 941 requires the federal regulators to define standards for exempt QRMs, and an interagency committee is currently working on the requisite standards for QRMs.[46]

In response to the proposed legislation, critics in the banking industry have argued that no bank will be willing to make mortgage loans at reasonable rates under the new rules because risk retention

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[40] Dodd-Frank Wall Street Reform and Consumer Protection Act § 941, 12 U.S.C. § 5301 *(2010).*
[41] FINANCIAL STABILITY OVERSIGHT COUNCIL, MACROECONOMIC EFFECTS OF RISK RETENTION REQUIREMENTS (2011).
[42] *Id.* at 2.
[43] *Id.* at 20-21.
[44] Bethany McLean, *The ABCs of QRM*, SLATE, Feb. 10, 2010, http:// www.slate.com/id/2284673.
[45] *Id.*
[46] *Supra* note 3.

will result in higher costs for lenders and the industry overall.[47] As a result, bankers are lobbying for an expansive definition of QRMs that would result in few traditional mortgage loans being subject to the risk-retention requirement.[48] Those connected with discussions inside the regulatory agencies have suggested that regulators are leaning toward a QRM definition that will apply only to loans containing a down payment equal to at least 20 percent.[49] Industry commentators have argued that a QRM definition requiring higher down payments will result in fewer homeowners being eligible for QRM mortgages, as a large percentage of U.S. homebuyers make down payments of less than 10 percent, and low down payments under the proposed regime would result in prohibitively high interest rates for such borrowers.[50] Federal regulators have until April 17, 2011 to finalize a proposal on the QRM issue.[51] Once released, the proposal will be open for comment and there will likely be aggressive lobbying, with banks arguing that eliminating any loan from the QRM definition is equivalent to denying a mortgage to a needy borrower, restricting credit to otherwise eligible homebuyers and leading to a further deterioration of the housing market.[52]

E. Incentive Based Compensation

On February 7, 2011, the FDIC approved a proposal to engage in joint rulemaking to implement Section 956 of the Dodd-Frank Act.[53] Section 956 prohibits incentive based compensation arrangements that contribute to inordinate risk taking by covered financial institutions and that are deemed excessive, or might lead to material losses.[54] The proposed new rules aim to change a compensation culture that encouraged risk taking and helped ignite

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[47] Floyd Norris, *Looks Like Banks Lose On Risk Plea*, N.Y. TIMES, Feb. 18, 2011, at B1.
[48] *Id.*
[49] *Id.*
[50] *Supra* note 44.
[51] *Supra* note 47.
[52] *Supra* note 44.
[53] Press Release, Federal Deposit Insurance Corporation, FDIC Board Approves for Public Comment Interagency Rule to Implement the Incentive-Based Compensation Requirement Under Dodd-Frank Reform Act (Feb. 7, 2011).
[54] *Id.*

the financial crisis.[55] The new rules require banks with over $50 billion in assets to defer 50 percent of their top executive incentive based compensation for at least three years.[56] The rules also require the boards of covered financial institutions to identify and approve incentive compensation of employees whose actions can cause such firms to suffer a material loss.[57] More significantly, the rules link executive compensation to bank performance in order to limit cash payouts that reward executives for short-term returns, without regard to long-term risk.[58]

The proposed rules, if approved, will apply to firms such as Goldman Sachs Group Inc., Morgan Stanley, and mortgage-finance giants Fannie Mae and Freddie Mac.[59] Smaller firms with at least $1 billion in assets would be subject to less stringent rules but must nevertheless satisfy regulators that the firm's incentive-based compensation strikes a balance between risk and reward.[60] In a public statement, FDIC Chairman Sheila C. Bair noted that the new rules will better align U.S. compensation standards with international standards previously approved by the Financial Stability Board in 2009,[61] however, Chairman Bair acknowledged that international counterparts have moved faster on executive compensation reform, and in some cases have enacted more stringent rules.[62]

Opponents of the new measure argue that large Wall Street bonuses were not a cause of the financial crisis and a government mandated one-size-fits all policy is generally inappropriate.[63] Proponents of the measure, on the other hand, have responded to the new rules with skepticism, noting that while the measures might move the United States closer to international standards, regulators have left a large deal of discretion to boards of directors in determining exactly how to frame their incentive based compensation

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[55] Editorial, *It May Make Them Think Twice,* N.Y. TIMES, *Feb. 12, 2011, at WK7.*
[56] *Id.*
[57] *Supra* note 3.
[58] Dave Clarke Reuters, *Bankers Could See Bonuses Delayed; U.S. Proposal Would Defer Money, But Crackdown Not As Strong As In Europe*, SUN SENTINEL, Feb. 8, 2011, at 3D.
[59] Victoria Mcgrane, *Big Banks Confront New Bonus Onus*, WALL ST. J., Feb. 8, 2011, at C3.
[60] *Id.*
[61] *Supra* note 3.
[62] *Supra* note 3.
[63] *Supra* note 59.

policies.[64] Critics have noted that although the FDIC proposal suggests that banks balance risks taken by their executives with their respective financial rewards in a manner that does not provide incentives for inappropriate risk taking, the FDIC has not provided concrete guidance for achieving such a goal, but has merely suggested that banks adjust bonuses based on the risk that a top executive is deemed to impose on a given institution and to defer payment of such bonuses to a future date in order to ensure that such risks have materialized in financial gains for the institution.[65] Critics have also questioned how regulators will be able to enforce the new regime, but acknowledge that reports mandated under the new rules will force management to consider more deeply the risks associated with the firm's incentive based compensation plans.[66]

F. Conclusion

Pursuant to its mandate and authority under Dodd-Frank, the FDIC has taken significant action toward maintaining a stable U.S. financial regulatory system in order to mitigate the effects of the financial crisis, and has implemented new rules to curtail excessive risk taking by financial institutions. This article highlighted some of the FDIC's most recent efforts to implement provisions of Dodd-Frank and discussed current debate surrounding the agency's proposals. The months that follow will set the stage for final resolution of many of the FDIC's rulemaking efforts pursuant to Dodd-Frank.

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[64] Joe Adler, *Pay Plan Stops Short of Tougher European Standards*, AMERICAN BANKER, Feb. 8, 2011, http://www.americanbanker.com/issues/176_26/fdic-executive-compensation-1032614-1.html.
[65] *Id.*
[66] Ellen R. Marshall & John J. Heber, *Incentive-Based Compensation for the New Banking Environment*, Manatt, Phelps & Phillips, LLP, (2011) Feb. 14, 2011, http://www.manatt.com/news-areas.aspx?id=13250.
[67] Student, Boston University School of Law (LL.M. 2011).

Your introduction and conclusion act as bridges that transport your readers from their own lives into the â€œplaceâ€ of your analysis. If your readers pick up your paper about education in the autobiography of Frederick Douglass, for example, they need a transition to help them leave behind the world of Chapel Hill, television, e-mail, and The Daily Tar Heel and to help them temporarily enter the world of nineteenth-century American slavery. Introduction definition: The introduction to a book or talk is the part that comes at the beginning and tells you | Meaning, pronunciation, translations and examples.Â Ellen Malos, in her introduction to 'The Politics of Housework', provides a summary of the debates. [+ to]. Synonyms: opening, prelude, preface, lead-in More Synonyms of introduction. 2. countable noun [oft in names]. If you refer to a book as an introduction to a particular subject, you mean that it explains the basic facts about that subject. introduction â€” introduction , prologue , prelude , preface , foreword , exordium , preamble are comparable when denoting something that serves as a preliminary or as an antecedent to an extended treatment , development , discussion , or presentation (as in an exposition â€¦ NewDictionaryofSynonyms. introduction â€” Introduction . s . f . v . Action par laquelle on introduit . Il ne se dit guere des personnes qu en cette phrase . L Introduction des Ambassadeurs , Ny des choses au propre qu en cette phrase . Self-introduction examples. There are many types of self-introductions you may deliver at various points throughout your career. Below are samples suited to some of the most common situations you may encounter: Self-introduction sample for a job interview. Self-introduction sample for a presentation. Self-introduction sample for networking. Self-introduction write-up sample. Self-introduction sample for a job interview. â€œMy name is Riley See. Iâ€™m a recent elementary education graduate from Ball State University.