THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

KEYNOTE ADDRESS: THE ROAD AHEAD

A Washington insider explains how the landmark Dodd-Frank Act will dramatically change the banking and financial services industry

Statement by the
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Thank you. I am honored to speak with you today about the Dodd-Frank Act. Let me just say – I have never seen so many community bankers from across the country in one room. We have 570 bankers from 45 states representing the towns of Altoona, Pennsylvania; Blue Island, Illinois; Naugatuck, Connecticut; Plano, Texas; and hundreds of others. Thank you for the work you do and the towns you serve. Welcome.

I have lived and breathed Washington for the past 30 years – and I've never seen anything like the times we are going through now. It's like trying to roundup a longhorn stampede with a piece of dental floss. The rapid-fire decisions being made on both sides of Pennsylvania Avenue –from Capitol Hill to the federal agencies – are changing our industry each day.

On July 21, 2010, President Obama signed into law the largest single piece of financial reform legislation in our nation's history. It's called the Dodd-Frank Act, and worse than that sometimes. It is the kitchen sink of financial legislation, making rules here, there, and everywhere. It has the potential to do some good, and unfortunately, it has the potential to do some harm. It surely will change the way that business is done.

However, I'm not here to commiserate the impact of this law. No, I'm here to make sense of it and ensure that our industry, economy, and country stay as competitive, stable, and prosperous as ever.

I offer my views on the road ahead as the President and CEO of the Financial Services Roundtable. The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Some of these banks are larger than you, but this doesn't mean we're more important. The financial services industry is a vast network – from the largest to the smallest institution - we are all connected. The knee bone is connected to the leg bone which is connected to the ankle bone. Each of my members is related to you as a supplier, customer, investor, or partner. We are all in this together. If regulators decide to target the largest bank in America, you can bet your bottom dollar that this regulation will also impact you too.

It is important for our industry to remember at the beginning of any conversation about Dodd-Frank that it is widely popular. Over three-fourths of House and Senate members agreed to it in its final vote, and it is the only piece of legislation from the 111th Congress that the majority of Americans support. (Now, that's not saying much).

For good or ill, the Dodd-Frank Act is the **law of the land**. It is not a campaign speech. It is not a proposal. It is not even a sound bite. It is the law of the land enforced by a sheriff with a posse, rope, and gun. There are clear changes that the industry needs to implement. Ready or not, Dodd-Frank's 2,300 pages of 300 plus rules and studies are here to stay.

Ordinarily, for a speech like this, I'd offer the "Big 3." But try as I might, I couldn't get it down to three points. The good news is, (and you should be grateful for this), I did get it down to 20 of the most important takeaways. I've never given a speech with 20 points before, but this is a massive overwhelming law. We'll have time afterward for questions and answers. Hold onto your seats, we are going to go through this pretty fast.

TOP 20 for 2011

The Top 20 for 2011. We're going to start with big principles and then narrow it down.

1. Rules, Rules, Rules "Pay Attention"

a. There are well over **<u>300 rulemakings and studies</u>**, not to mention the new agencies created by Dodd-Frank that have wide-open rulemaking authority.

b. We are 6 months into the regulatory process, and the industry has been challenged as we try to offer thoughtful comments about upcoming rules and how they will impact lending and economic recovery. The Roundtable filed 28 comment letters in the past 90 days – and 62 in 2010 **<u>– this is three times more</u> than we filed in 2009 *on all issues***.

c. <u>The challenge for you is to pay attention. No matter how difficult it is, we the industry must keep track of these rules. It is tempting to prioritize, but one man's priority is another man's poison. We must follow them all.</u>

2. Agencies "They're Implementing the Law"

a. In the face of 30-day comment periods and rapid-fire rules, it is easy to vilify the agencies themselves.

b. <u>Be respectful. It's not personal.</u> The agencies are filled with smart, responsible people who are trying to do a job that's very technical and difficult. That's why we call them public servants.

c. Also, to clarify, we cannot fix Dodd-Frank by cutting funding. That would mean we still get the same rules, only with less attention and resources dedicated to making sure they're done right. Cutting funding is *not only not a solution,* it creates a new problems.

3. Joint Rulemaking "TX Chicken Fight"

a. Dodd-Frank calls for **46 joint rulemakings** – a historic level of interagency coordination – which at best is an unnatural act, and at worse, is a giant chicken fight with 200 chickens all in one henhouse.

b. The following agencies have been tasked with joint rulemaking and are setting up coordination processes: Treasury; Federal Reserve; FDIC; OCC; SEC; CFTC; FSOC; and the grandmother of them all, the Consumer Financial Protection Bureau, (more on this later). Even the Department of Labor and the Department of Defense are involved in Dodd-Frank.

4. Your Responsibility "Comment on Everything"

a. In the midst of rulemakings…and joint-rulemakings…your responsibility is to **comment on everything**. If you have an opinion on it – write a letter. Get on a trades' email list and comment on their comment letters. Somewhere your opinion will add to the discussion.

b. As we say bird hunting, shoot at everything that moves, and take credit for what falls. Talk to your local chamber, your customers, your representatives, your Congressmen. **I promise you, if you speak, you will be heard.**

5. Convergence "The Business Model Going Forward"

a. Ultimately, this is a difficult regulatory and economic environment.

b. Small banks will continue to start up and be successful, particularly those with an exit strategy.

c. Going forward, as the conference title suggests, you need to decide if you want to acquire or be acquired. Only banks that can keep up with these regulations will succeed. That will take infrastructure and overhead, which small banks don't have an abundance of.

Now, let me walk through some specific Dodd-Frank provisions to watch out for:

6. Systemic Risk "The Elephant in the Room"

a. The Financial Stability Oversight Council has already designated 36 bank holding companies as systemically important, and that list is expected to grow. By and large, these new firms will be subject to increased prudential standards and will have to restructure themselves accordingly.

b. **But FSOC does not only apply to banks over $50 billion in assets**. It applies to *all banks and nonbanks over and under $50 billion* because it has the power to propose more heightened standards and safeguards for *any specific activity or practice of any company* that FSOC deems will increase the risk of liquidity, credit or other systemic problems.

c. <u>Don't write off the Financial Stability Oversight Council</u>. It can apply to your banks' activities and it most likely will.

d. Furthermore, watch out for the **ricochet effect**. If FSOC sets a 10% capital level for large banks and it works well, don't be surprised if those same prudential standards are demanded of you.

7. Risk Management "The New Game in Town"

a. The banks that *knew the risks* of subprime mortgages and falling home values were the ones who *best survived* this last crisis.

b. My advice, you need to know your risk early and deal with it. If you don't have a Chief Risk Officer – get one. You need to know your primary exposure, secondary exposure, and tertiary exposure before the regulators do.

8. New Mantra "Treat Customers Fairly"

a. The broadest power of the Bureau is its ability to regulate "abusive practices." We're not talking about just payday loans and subprime mortgages. We're talking about offering **anything** your customers don't understand.

b. Now, this is REALLY important. I'm going to slow it down. It is no longer what you say – but what your customers understand. I know this sounds unfair, and maybe it is. But those are the words of the statute.

c. I encourage you to get on the front end of that regulation – and catalog your products to find out for yourself which ones are confusing. Use "Mother's

Rule”: Every senior officer at your financial company should be willing to sell their goods/services to their mothers. If it doesn’t pass the rule, stop offering it.

d. In other words, I encourage you to make changes before they tell you so. The best way to succeed with the Consumer Financial Protection Bureau is to be proactive.

9. Debit Cards “Price Controls”

a. This is the worst single item in the Dodd-Frank Act. Let me remind you, it was adopted with no hearing, no committee consideration, no House vote, and only two hours of debate.

b. Congress’ decision to put price controls on a new innovative financial product is shocking. Equally shocking, is the Federal Reserve Board’s decision to place an arbitrary and hard cap on debit interchange fees. This will drastically change the way consumers are accustomed to paying and potentially damage our economic recovery.

c. I don’t know the outcome. But the Federal Reserve’s proposal reduces interchange fees by an average of 84% and forces banks to process debit cards below their cost. If allowed to stand,

    i. More low and moderate income consumers will not qualify for checking accounts and debit cards.

    ii. Or, banks will have to reprice debit, stop issuing it, or charge customers directly for it, which you know is hard to do.

d. Debit cards are not free. One banker told me it costs his company $300 to issue debit cards and maintain checking accounts.

e. This is urgent - call your Congressman. Call your mother's Congressman. Call the Congressman in the next town over. Call them again next week too.

10. Prudential Standards "Capital Is King"

a. Our companies have increased capital by 31% over the last three years as a result of regulatory requirements, Basel, the stress tests, market discipline, instruction by shareholders, common sense, and leadership by the industry, *all prior to the Dodd-Frank Act.*

b. Now, Basel III is mandating a 7% capital level layered with a 2.5% conservation buffer and a 0-2.5% countercyclical buffer on top of that. The way I add that up – that's 12% capital and that takes your breath away.

c. I don't know what the final outcome will be, but I know that overly strict capital standards **may indeed limit the flow of credit** into our economy – but you as an institution need to get over it, and you need to make it work.

11. Data Collection "Hand Over the Paperwork"

a. This new Office of Financial Research is created to support the Financial Stability Oversight Council. Its significant data-gathering power *is not limited* to systemically-important firms. It applies to you too.

b. As OFR continues to develop, take a look at what you already report to regulators and where it's duplicative – and tell the OFR about it.

c. <u>But the big thing is, when you're asked for data, give it to them. It is not a request, it is an order with **subpoena power.**</u>

12. Corporate Governance "Shareholders Rule"

a. Under Dodd-Frank, shareholders will get a non-binding vote on executive compensation, golden parachutes, and proxy access.

b. Additionally, the Federal Reserve and government agencies are given power to comment on your compensation plans – and **when they comment, everyone listens.**

c. The compensation debate in the regulatory sphere is generally about the *structure* of compensation, not the *amount* of compensation that politicians and the media discuss. This is a good thing.

d. Make sure your compensation plans pass the "Bring Home to Mama" test. If you can't explain it to your mother, and have her smile and nod, do something different. Remember, mama has a right to vote now.

13. Derivatives "Big Unknown"

a. This could be biggest hit on the industry, and it is the least understood.

b. There are just over 40 rules that have to be made by July concerning derivatives. It is still unknown which derivatives will be regulated – somewhere between some and all.

c. Some market participants told regulators that they believe **70%-80% of all derivative transactions could be cleared.** To put this in perspective, FDIC-insured commercial banks hold *$236 trillion* in derivatives. 80% of $236 trillion is *$210 trillion* – ***that's big even in Texas.***

d. My hope is you continue to offer derivatives to your customers because they are a needed and valuable product.

14. Resolution Authority "End of Too Big Too Fail"

a. This one also is still in the TBD category.

b. During the last crisis, the statutory authority to provide an orderly closing to a large, complex, nonbank financial institution was somewhere between non-existent and inconsistent. Thus, there were a wide range of responses: from "Pull the Plug Lehman"; to the "AIG Zombie"; the "Wachovia Bidding War"; and "Chapter 11 Bankruptcy of CIT."

c. In the next crisis, the system, first, will hopefully not collapse at all. If the failure of a systemically important firm occurs (one that could compromise the entire financial system), the Treasury now has the explicit authority to close the institution, fire its management, and compensate shareholders.

d. No, it's not perfect, but it is a more coherent system than what we had before.

Regulation is only part of the process of rebuilding our financial system and our economy. Outside the scope of the Dodd Frank Act, there are other forces occurring simultaneously:

15. Outside Directors "Huge Responsibility, Huge Liability"

a. Now listen carefully - this is the part where you get sued. This is serious.

b. On November 1, 2010, the FDIC filed suit against Heritage Community Bank to recover $20 million in losses from alleged negligence of 11 of Heritage's former directors. This is part of a broader trend.

c. The FDIC said that as of mid-December it had authorized suits against 109 directors and officers of failed financial institutions as it tries to recover nearly $2.5 billion. The agency, which saw 157 banks fail last year, may sue bank directors and officers for what it deems gross or simple negligence.

d. <u>Directors are responsible to comply with the letter and spirit of the law, and liable for both.</u> It's not pretty, but it's reality.

16. Fair Value Accounting "Time to Rethink"

a. The industry has had trouble with fair value accounting for some time, and FASB has turned a deaf ear.

b. But there is a new chair, Leslie F. Seidman, who is now listening.

c. It appears like we will move closer to IFRS standards, if successful.

17. Changing Demographics "Boomers Still Rule"

a. Boomers have been in charge since the first Boomer, Kathleen Casey-Kirschling, was born one second after midnight on Jan. 1, 1946. She filed for early retirement on October 16, 2007, becoming the first baby boomer to start collecting Social Security – the first of an 80 million pack.

b. This year, 10,000 boomers a day will turn 65.

c. This, ladies and gentlemen, is your new market.

    i. Your job is to capture the market of the Boomers as they pour money into their retirement accounts. Americans now have about $7.1 trillion invested in private retirement plans as they realize that they will have to finance their own retirement.

    ii. Your second job is to manage these savings. <u>You will need to double and triple your capabilities to keep up.</u>

18. Politics Matter "Speak Up"

a. Democracy is not a spectator sport. In the last three election cycles, we've seen only the ones who speak get heard.

b. You need to be on a first name basis with all of the Congressmen and women in your footprint. You should have already attended town halls and met candidates by now. You should be first on your Congressman's list for banking-related issues.

19. Global Harmonization "Think Big"

a. I mentioned in the beginning how large banks and small banks were connected to each other – turns out, we're connected around the world.

b. Our customers are abroad:

   i. Maybe you are financing crops that are being sold to Europe.

   ii. Maybe you're financing or insuring a car made in Korea.

   iii. Maybe you're financing the U.S. operations of an international company or the employees of the company.

c. Think big – beyond your company, state, country, and beyond Dodd-Frank as many prudential standards are harmonized internationally.

20. Economy "It's All Still About the Economy"

a. It begins and ends with the economy. Fortunately, we are moving out of the recession. The Congressional Budget Office predicts 3.1% growth this year and 5.6% from 2012-2014, and consumer confidence is increasing. But it is still fragile.

b. In the President's State of the Union Address, **"jobs**" was the word used most often in his speech**: "economy"** was second.

c. There are three things I want you to remember about the economy:

i. Speak up for an independent Federal Reserve. The Federal Reserve may make mistakes, but it's all we've got and it's essential for a stable money supply.

ii. Speak up for the certainty of tax rates. Businesses have $1.9 trillion of cash on the side right now. This is 28% more than 2009 levels. Businesses and households will only invest when there is certainty.

iii. Speak up against the looming federal deficit. Federal debt is 62% of GDP. The CBO projects that if we continue on our current course, federal debt will reach 90% of GDP by 2020 and 185% of GDP by 2035. If this happens, Noah's flood will look like spring showers. Support those willing to reduce the federal deficit.

To conclude, as an industry, we are and need to continue proactively working with customers, shareholders, legislators, and regulators to make sure these changes are done right. Our job is to finance the economy – consumers and businesses alike – within the framework of the regulatory system adopted by the statute.

Last fall, there was a New Yorker article by John Cassidy that accused banks of not making anything tangible. "What Good is Wall Street?" was the title of the article. First, our banks are on **Main Street**. Second, when you ate dinner last night, chances are you paid for the food with a credit card or debit card, and further, the supermarket or restaurant bought the food and made its payroll through a bank, and the farmer financed his production through crop loans. You bought your home with a mortgage, you financed your children's education through investment or debt or both, your job was created by equipment or inventory lending, and you drive a car with insurance protection and perhaps an auto loan or lease. If you live in it, work at it, drive it, wear it, eat it or run a business with it – the financial services industry financed it or it didn't happen.

For that reason, let me say I have never been more proud to be a representative of the financial services industry.

The industry has accepted responsibility for our role in the economic crisis and our role in economic recovery. We take responsibility for helping rebuild America's financial future. Thus, in the midst of regulatory chaos, we are moving forward, and I – on behalf of the Financial Services Roundtable and the member companies we represent – am 100% focused on the business of financing our customers, our communities, and leading America to economic recovery and growth as we travel on the road ahead. I know you are too.

Now, as my pappy used to say, "Good luck, and Good hunting"

[Take Questions]

To close, I want to put responsibility back on you. There's a story of a Chinese philosopher whose student presented him with a conundrum. The student said, "In this hand, I have a small delicate bird. Is it dead or alive?" The Chinese philosopher knew it was a conundrum. If he said the bird was dead, the student would open his hand and let the bird fly away. If he said the bird was alive, the student would surely crush the bird with his fist. So the Chinese philosopher wisely answered, "The answer, dear one, is in your hands."

The answer to success or failure, ladies and gentlemen, is in your hands.