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

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The End of the World*

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This is the way the world ends
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Not with a bang but a whimper
T.S. Eliot — "Hollow Men"

As this year ends, there are potentially industry-changing regulations and practices on the horizon, as well as significant fiscal problems. Some say they will eliminate the way business has been done. Some are unsure.

Signals:

- The Consumer Financial Protection Bureau is required to publish its final rule on the Ability to Repay provisions of the Dodd-Frank Act by January 21, 2013. That rule must include a decision with respect to what mortgages will be qualified mortgages, and what protections are available to those who make such loans. The proposal tracks the statute and effectively guarantees that the rule will constrain housing credit.

- Six agencies must publish a rule covering risk retention requirements under the Dodd-Frank Act and have promised to do so after CFPB publishes its ATR rule in final form. The latest drafts publicly available includes a premium capture cash reserve plan, a severe restraint on housing credit that was never even discussed in Congress. There is unanimous belief in the industry that that rule, as drafted, will cripple any rejuvenation of a private secondary mortgage market.

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

- Final rules for other major mortgage regulations are due to be published by CFPB by January 21, 2013, and by statute must be effective no more than 12 months later. Implementation of major rules by large mortgage lenders and servicers generally requires an implementation period of 18-24 months. When multiple regulations are issued simultaneously, the implementation period is necessarily longer.

- Basel III rolls on.

- Lenders will be reluctant to lend outside the QM definitions, and LMI borrowers in large numbers will likely have trouble meeting the criteria for a QM. Most lenders will make a few exceptions to that policy. The Justice Department has said it will continue to enforce Fair Lending laws using the disparate impact theory.

- As we file our electronic databases with historical records, we realize that FORTRAN and COBAL are still used and translatable, but all the first generation programming languages that powered the Univac and IBM 701, as well as all the other assembly programming languages, are no longer translatable.

- The Office of Financial Research and the Consumer Financial Protection Bureau are determined to collect massive streams of data without knowing the precise use to which such data will be put. The National Security Agency collects more data than it can analyze in real time.

- The largest financial institutions must organize themselves to be liquidated, regardless of whether that leads to better or worse efficiencies, service to customers, or productivity. If they do arrange themselves as the FDIC wants, they still get no special capital consideration. Safety and soundness considerations are not a driving consideration in the analysis of sufficiency of living wills.

- Most studies have shown that banks fail irrespective of their capital position just prior to failure, non-intuitive as that may seem. The present solution to prevent failures of institutions seems to be heavily weighted to increasing capital strength.

- Life insurance companies seldom fail, and when they do, obligations to policyholders have always been met. Unlike bank depositors, policyholders' claims for benefits come due over a long period of time, not immediately. Yet, because AIG ventured far outside traditional insurance activities, large insurance companies are being considered as potentially systemically risky regardless of the degree of their interconnectedness to others in the system.

- Our economy can always count on markets in Europe, Asia and Canada. Europe has a few problems just now, no one can do an understandable accounting of Chinese companies, so hail O' Canada!

- Key economic decisions will be made during the next number of months by our congressional representatives. An understanding of economics is not required of our elected Members. We hope there are a significant number of them that can (a) draw and explain a simple supply and demand curve with one or two variables; (b) explain the components of gross domestic product and balance of payments; and (c) rationally discuss the social security system financial condition and its financial projections.

- State governments are having financial problems, some more than others. No one has quite figured out why. Illinois has the 5th highest debt per capita in the country (just to pick a state at random), yet the states neighboring on its east and west borders have the 8th (Iowa) and the 3d (Indiana) lowest DPC. State governments as a whole have more than $4 trillion of debt outstanding.

- Immigration into the U.S. exceeds emigration out of the U.S.

> "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way...." Charles Dickens, Tale of Two Cities.

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