

Financial Reform

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Now that financial reform has been enacted into law, what does it mean for consumers and investors? The reform bill was immense (about 2,300 pages), but here are some highlights:

>There will be a new "Financial Protection Bureau" under the authority of the Federal Reserve Board. The Bureau will review the terms from lending from a variety of sources, including commercial banks, credit unions, mortgage bankers and brokers, pay advance companies, and providers of consumer installment loans. The Bureau will seek to enforce clarity in lending; the terms of a loan, including interest rate and repayment schedule, should be plain and understandable. If you have a question, you will be able to call into a consumer phone hotline. The Bureau will also, it is hoped, clamp down on deceptive lending schemes.

>There will be a radar type of system to foresee looming financial failures of very large financial institutions. This authority will be exercised by a Financial Services Oversight Council, on which the Secretary of the Treasury and other federal officials would serve. The Oversight Council could mandate asset sales of a financial institution, if deemed necessary.

>There would be authority to break up troubled financial institutions. Governed by the Federal Deposit Insurance Corporation, this power would allow FDIC to shut down and either reorganize or liquidate banks that fall below minimum standards. This provision is meant to cover situations such as the federal government faced in the Bear Stearns, Lehman Brothers and Wachovia matters, for example. The US Treasury would pay the immediate cost, but the bill calls for those costs to be recouped by levies on large financial institutions.

>There will be tough new regulations on derivative financial instruments, including swaps, especially those that do not trade on an organized exchange or clearing house.

>Mortgage finance. Mortgage lenders will be required to tighten rules regarding approval of mortgage loans, to make sure borrowers can afford to repay their mortgages. To keep banks aware of the risks they are taking, they will have to retain a 5% stake in pools of mortgages aggregated for sale. The legislation notably does not address the role of the FHA, Fannie Mae and Freddie Mac in precipitating the mortgage meltdown.

>The bill also restores certain distinctions between investment banks and depository institutions (including commercial banks) that had been dissolved in recent years. Supposedly, depository institutions guaranteed by FDIC will not be allowed to engage in "proprietary trading" (trading for their own account). Proprietary trading is probably the most lucrative and risky activity that Wall Street engages in. Depository institutions will look for clever ways around this rule. Depository institutions will not be allowed to invest more than three percent of capital in hedge funds or private equity funds

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