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Obama Administration Proposes New Legislation to Regulate Financial Institutions

President Obama recently released a white paper entitled "Financial Regulatory Reform: A New Foundation," proposing the most comprehensive regulatory reform to the U.S. financial system in decades. The Obama Administration submitted proposed legislation to Congress on July 22 and 23 that would implement the white paper's proposed reforms. Notably, the proposed legislation would (i) create the Financial Services Oversight Council (Council); (ii) designate the Federal Reserve (Fed) as the regulator for financial institutions that pose a systemic risk to the financial system (Tier 1 financial holding companies (FHCs)); (iii) create one national regulator to oversee all national banks; (iv) increase regulatory standards for FHCs; (v) eliminate exemptions in the Bank Holding Company Act of 1956; (vi) change regulations for critical markets, such as securitization and clearing; and (vii) establish a framework for the federal government to prevent significant non-bank financial institutions from failing.

Financial Services Oversight Council

- The Council will act as the watchdog for the entire financial system. Responsibilities would include monitoring the marketplace for potential threats to the U.S. financial system and recommending which institutions should be categorized as Tier 1 FHCs.
- The Fed must consult with the Council before prescribing rules for Tier 1 FHCs, establishing prudential standards for Tier 1 FHCs, designating financial intermediaries as systemically important, and providing risk management strategies for those intermediaries.

The Federal Reserve as the Systemic Risk Regulator

- The Fed will regulate and supervise financial institutions that pose a systemic risk to the U.S. financial system, the so-called Tier 1 FHCs. An entity may be classified as a Tier 1 FHC if it engages, directly or indirectly, partly or completely, in activities that are financial in nature. This casts a broad net to prevent large, systemically significant institutions from being subject to different regulatory requirements.
- Tier 1 FHCs will be subject to regulations more stringent than those applied to bank holding companies. Regulations developed by the Fed must include: (i) risk-based capital requirements; (ii) leverage limits; (iii) liquidity requirements; and (iv) overall risk management requirements. Furthermore, Tier 1 FHCs are required to be "well capitalized and well managed" at all times.

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Creation of a National Bank Supervisor

- The National Bank Supervisor would consolidate the powers of the Office of the Comptroller of the Currency and the Office of Thrift Supervision.
- The legislation also eliminates the federal thrift charter.

Raising Regulatory Requirements

- All FHCs would need to be “well capitalized” and “well managed,” increasing minimum capital requirements. The proposed legislation will also create new restrictions between bank holding companies and their subsidiaries and affiliates to prevent possible conflicts of interest.

Eliminating Exemptions to the Bank Holding Company Act

- Credit card banks, industrial loan companies, and other affected banks that become bank holding companies under the new legislation will have 90 days to register as bank holding companies. They will then be subject to the requirement that they, their subsidiaries, and their holding companies may not engage in non-financial activity.

Regulating Securitization and Clearing

- Parties that securitize asset-backed securities will be required to retain at least 5 percent of the credit risk of the underlying assets.
- The Federal Deposit Insurance Corporation (FDIC) will regulate systemically important payment, clearing, and settlement activities.

Preparing Financial Regulation to Respond to Future Financial Crises

- The U.S. Treasury would have the power to install a receiver or conservator of systemically important failing financial institutions. For institutions that are primarily brokers or dealers, the Securities and Exchange Commission would likely act as the receiver or conservator. Otherwise, the receiver would be the FDIC.

Future Developments

This proposed legislation is likely to go through substantial changes before it is enacted. We will continue to monitor developments and issue updates as the legislation progresses through Congress.

