

# Financial Recovery Alert

June 22, 2009

## President Obama Outlines a Five-Part Framework for a “New Foundation” for Regulatory Reform of the U.S. and Global Financial Markets

The following is a detailed summary of President Obama’s regulatory framework:

### I. Requiring Strong Supervision and Regulation of All Financial Firms

#### Increased Oversight of Systemic Risk and Financial Regulation

##### Create a Financial Services Oversight Council:

- The President’s plan will create a Financial Services Oversight Council, chaired by Treasury, to help fill gaps in regulation, facilitate coordination of policy and resolution of disputes, and identify emerging risks in firms and market activities.
- The Financial Services Oversight Council will replace the President’s Working Group on Financial Markets and will have a permanent, full-time staff at Treasury. The Council will:
  - have broad authority to gather information through the Chair from any financial firm to identify emerging risks to financial stability
  - identify gaps in regulation and prepare an annual report to Congress on market developments and potential emerging risks
  - recommend firms for identification as Tier 1 Financial Holding Companies (FHCs) that should be under consolidated supervision by the Federal Reserve
  - provide consultation on material prudential standards for Tier 1 FHCs and systemically important payment, clearing and settlement systems
  - provide a forum for discussion of cross-cutting issues among the principal federal financial regulatory agencies
  - facilitate information sharing and coordination among the principal federal financial regulatory agencies regarding policy development, rulemakings, examinations, reporting requirements and enforcement actions

- The Council will have eight members, one from each of the principal federal financial regulators: (1) the Secretary of the Treasury, who shall serve as the Chair; (2) the Chair of the Board of Governors of the Federal Reserve System; (3) the Chair of the Commodity Futures Trading Commission (CFTC); (4) the Director of the newly-created Consumer Financial Protection Agency; (5) the Chair of the Federal Deposit Insurance Corporation (FDIC); (6) the Director of the Federal Housing Finance Agency (FHFA); (7) the Director of the newly-created National Bank Supervisor (NBS); and (8) the Chair of the Securities and Exchange Commission (SEC).

### II. Strengthening Consumer Protection With a Strong, Independent Agency With Full Authority to Protect Consumers

#### Create a Consumer Financial Protection Agency:

As part of the President’s plan, the new agency will have broad authority to protect consumers of credit, savings, payment and other consumer financial products and services, and to regulate all providers of such products and services. The Agency will be responsible for:

- promoting concise and clear information for consumers, and protecting consumers from unfair and deceptive practices
- promoting fair, efficient and innovative financial services markets for consumers
- improving access to financial services

#### Give Consumer Financial Protection Agency Full Authority to Enforce Proper Protections:

The Agency will be structured to be independent and accountable with an empirical approach to regulation and a stable source of funding. CFPA will have authority to:

- write rules across bank and nonbank firms for a level playing field and higher standards
- supervise and examine institutions for compliance
- enforce compliance through orders, fines and penalties
- write rules that serve as a floor, not a ceiling, with respect to state laws, and states will be empowered to enforce these strong rules

### **III. Improving International Regulatory Standards and Cooperation**

#### **Subject Foreign Financial Firms Operating Within the U.S. to the Same Standards as U.S. Firms:**

- Foreign firms whose U.S. operations pose risks to the U.S. financial system will be subject to the same robust prudential regulation and oversight as U.S. firms that pose risks to the U.S. financial system.

#### **Promoting Higher International Standards**

##### **Strengthen the International Capital Framework:**

- The Basel Committee on Banking Supervision (BCBS) will develop a simple, non-risk-based capital measure to limit the amount of leverage built up in the international financial system.
- The BCBS will improve Basel II by requiring more capital to offset riskier assets, such as trading book instruments, securitized products and off-balance sheet items.
- The BCBS will complete an in-depth review of the Basel II framework to mitigate its pro-cyclical impact on the global economy.
- The BCBS will strengthen the definition of “regulatory capital” to improve the quality, quantity and consistency of capital held by financial firms.

##### **Improve the Oversight of Global Financial Markets:**

- National authorities will be urged to promote the standardization and improved oversight of credit derivatives and other OTC derivative markets – in line with G-20 commitments.

##### **Reform Crisis Prevention and Management Authorities and Procedures:**

- The BCBS will expedite its work to improve cross-border resolution of global financial firms and develop recommendations by the end of 2009 to help ensure that countries have powers and tools necessary to quickly resolve a failing financial firm.

#### **Enhance Supervision of Internationally Active Financial Firms:**

- The Financial Stability Board will strengthen international cooperation on the supervision of global financial firms through supervisory colleges.

### **IV. Strengthening Regulation of Core Markets and Market Infrastructure**

#### **Addressing the Critical Markets That Contributed to Today’s Crisis**

##### **Strengthen Supervision of Securitization Markets:**

- Banking regulators will issue regulations that require the originator of a securitized loan, or the sponsor of a securitization to retain 5 percent of the credit risk of securitized exposures.
- The SEC will continue its efforts to increase the transparency and standardization of securitization markets, and be given clear authority to require robust reporting by issuers of asset-backed securities.
- The SEC will continue its efforts to tighten the regulation of credit rating agencies, including measures to ensure that firms have robust policies and procedures that manage and disclose conflicts of interest and otherwise promote the integrity of the ratings process.
- Regulators will reduce their use of credit ratings in regulations and supervisory practices, wherever possible.

##### **Bring Comprehensive Regulation to the Markets for All Over-The-Counter Derivatives, Including Credit Default Swaps:**

- Credit default swap markets and all other OTC derivatives markets will be subject to comprehensive regulation in order to:
  - prevent activities in those markets from posing risk to the financial system
  - promote transparency and efficiency of those markets
  - prevent market manipulation, fraud and other market abuses
  - prevent OTC derivatives from being marketed inappropriately to unsophisticated parties
- These goals will be reached through comprehensive regulation that includes:
  - requiring transparency for all OTC derivative trades and positions through recordkeeping and reporting requirements

- empowering market regulators to take vigorous enforcement action against fraud, market manipulation and other market abuses
- requiring conservative regulation of all OTC derivative dealers and all other major participants in the OTC derivatives markets
- requiring standardized OTC derivatives to be centrally cleared and executed on exchanges and other transparent trading venues
- requiring higher capital charges for customized OTC derivatives

#### **Harmonize Futures and Securities Regulation:**

- The CFTC and the SEC will make recommendations to Congress on how to eliminate differences in statutes and regulations with respect to similar types of financial instruments that are not essential to achieving investor protection, market integrity, or price transparency.
- The CFTC and SEC will complete a report by September 30, 2009, with their recommendations.
- If the CFTC and SEC cannot reach agreement by the above date, their differences will be sent to the Financial Services Oversight Council, which will be required to make recommendations to resolve the differences within six months of its formation.

#### **Broad New Authority to Monitor Threats to Financial Stability From Activities in Financial Markets**

- A new Financial Services Oversight Council will have broad authority, through a permanent staff in Treasury, to require reports from any U.S. financial firm for the purpose of assessing whether activity in a financial market poses a threat to financial stability.
- The Council will be responsible for referring emerging risks to the attention of U.S. regulators with the authority to respond.

#### **Strengthening Oversight of Systemically Important Payment, Clearing and Settlement Systems**

- The Federal Reserve will be given stronger statutory authority to oversee systemically important payment, clearing and settlement systems.
- The Federal Reserve will be required to consult with the Financial Services Oversight Council to identify systemically important systems and in setting standards for those systems.

In the case of clearing and settlement systems for regulated markets, the Federal Reserve will be required to coordinate its oversight with the CFTC or the SEC, which will remain the primary regulators of such systems.

#### **V. Providing the Government With Tools to Effectively Manage Financial Crises Reducing the Likelihood and Impact of Failures**

##### **Impose More Stringent Capital, Activities and Liquidity Requirements on Large, Interconnected Firms (Tier 1 FHCs):**

- In view of the risks such firms introduce into the financial system, Tier 1 FHCs will be subject to more stringent capital, activities and liquidity standards, and more exacting prudential supervision.

##### **Require Prompt Corrective Action From Large, Interconnected Firms Should Their Capital Levels Decline:**

- Tier 1 FHCs will be subject to a prompt corrective action regime that would require the firm and its supervisor to take corrective actions as the firm's regulatory capital levels decline.
- This regime will mirror the prompt corrective action regime for insured depository institutions established under the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

##### **Planning in Advance for Orderly Resolution**

##### **Require Rapid Resolution Plans From All Large, Interconnected Firms:**

- The Federal Reserve will require each Tier 1 FHC to prepare and continuously update a credible plan for the rapid resolution of the firm in the event of severe financial distress.

##### **Providing a Regulatory Regime That Can Adequately Respond to a Financial Crisis**

##### **Provide the Government With Emergency Authority to Resolve Any Large, Interconnected Firm in an Orderly Manner:**

- The federal government will have the authority necessary to avoid the disorderly resolution of large, interconnected firms when the stability of the financial system is threatened.

- The proposed resolution authority would supplement (rather than replace) and be modeled on the existing resolution regime for insured depository institutions under the Federal Deposit Insurance Act.
- The Treasury Department can invoke the resolution authority only after consulting with the President and upon the written recommendation of two-thirds of the members of the Federal Reserve Board, and the FDIC or SEC as appropriate.
- To invoke this authority, the Treasury Department must make the following determinations:
  - 1) That the firm is in default or in danger of defaulting
  - 2) That the failure of the firm would have serious adverse effects on the financial system
  - 3) That the use of the special resolution authority would avoid or mitigate these adverse effects. The resolution authority will give Treasury the ability to appoint a receiver or conservator for the failing firm. In general, that role will be played by the FDIC though the SEC may be appointed in certain cases.
- The conservator or receiver of the firm will have a broad set of powers including authority to take control of the operations of the firm, or to sell or transfer all or any parts of the firm's assets. The resolution authority will also include the ability to provide loans, assume liabilities, or inject capital.

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