Weathering the Storm:

A Guide to Banking in Uncertain Times

Session 5: A Webinar on Regulatory Reform Legislation

A Jones Walker Webinar Series
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Introduction and Overview

- ❖ This is the fifth of six sessions addressing issues for bankers navigating a difficult banking environment.
- ❖ The first four sessions dealt with the current regulatory environment, the regulatory enforcement process, and the raising of capital and disposition of problem assets.
- ❖ This session will focus on:
  - ❖ Current proposals in Congress on financial regulatory reform

Effect of the Senate Legislation on the Supervisory Structure

1. Restructure of the bank regulators

❖ Fed will regulate all banks over $50 billion but lose all other banks and holding companies.

❖ The FDIC will regulate state banks and thrifts and their holding companies under $50 billion.

❖ The OCC will regulate all federally chartered banks and thrifts and their holding companies under $50 billion.

❖ The House bill preserves the federal thrift charter. The Senate bill grandfathers federal thrifts but provides there will be no new ones chartered.

Effect of the Senate Legislation on the Supervisory Structure

2. Fed consolidation and loss of regulatory oversight of most banks it now regulates

- ❖ Atlanta Federal Reserve Bank from 687 institutions to 2 institutions
  - ❖ Dallas from 498 institutions to 3 institutions
  - ❖ St. Louis from 646 institutions to 0
  - ❖ Kansas City from 982 institutions to 0
- ❖ In exchange, the Fed would regulate the 55 banks over $50 billion. And it would lose regulatory oversight of 4,974 holding companies and 844 individual state-chartered banks.

So, two Federal Reserve Banks would lose all institutions, and Atlanta, Richmond, Minneapolis and Dallas would be down to three or fewer institutions.

Effect of the Senate Legislation on the Supervisory Structure

3. There are other impacts on the Fed

- ❖ The President of the New York Fed will be subject to Presidential appointment and Senate confirmation. (The President of the New York FRB is a permanent member of the Federal Open Market Committee.)
- ❖ Also, would prohibit past or current bankers from regulated banks from being on the board of Federal Reserve Banks. Such banks won't even be able to vote for FRB directors.

Effect of the Senate Legislation on the Supervisory Structure

4. $50 billion cutoff is difficult to defend from a systemic risk standpoint.

- ❖ Banks between $50 and $100 billion would be subjected to costs and regulation as if they were systemically significant when in fact they are not.
- ❖ There will be higher risk-based capital requirements and leverage limits, as well as fees to fund the resolution fund for systemically significant entities.
- ❖ So, even though they will be treated as too big to fail, they won't be too big to fail and the disparate treatment will just hurt their stock price.

Effect of the Senate Legislation on the Supervisory Structure

5. **The catch phrases of Main Street vs. Wall Street and monetary policy being informed by supervisory authority belie real debate: turf.**
   - ❖ Fed defenders contend their supervisory role insures that they won't gear monetary policy to Wall Street at the expense of Main Street.
   - ❖ Fed defenders also contend that the current supervisory role benefits it in performing its monetary role.
   - ❖ The real debate, though, is more mundane than this. The Federal Reserve Banks are facing emasculation. And many banks under $50 billion don't want to be forced to undergo a new regulatory process.

Consumer Financial Protection Agency/Bureau

The House bill creates an ostensible independent regulatory agency. The Senate bill does the same thing as a practical matter.

- In both bills, the individual named to run the agency/bureau would be a Presidential appointee.
- The Senate bill puts the Bureau in the Fed. But the Fed would be statutorily barred from interfering with the Bureau. It can't intervene in an examination or enforcement action or delay or prevent a rulemaking. It would be analogous to saying that a landlord had control of a governmental agency as a result of being the landlord.
- Independent budget calculated by 10% of the Federal Reserve System's total operating expenses. This will provide the Bureau a huge budget of a half billion a year.
- The House bill provides, in addition to the 10% of the Fed's expenses, for assessments on banks and nonbanks, as well as appropriated funds. Dodd says his bill gives the Bureau greater independence. By 2013, it will go up to 12%.
- Senate bill takes the cost out of banks entirely; the House bill spreads the costs to nonbanks.

Consumer Financial Protection Agency/Bureau

Bureau's Administrator has virtually unfettered authority to promulgate rules with very vague statutory parameters.

❖A finding of "unfair, deceptive or abusive" practice is sufficient for him to regulate and prohibit.

❖The Senate bill gives the Financial Stability Oversight Council the right of veto over consumer regulations BUT it takes a two-thirds vote and the standard is an impossibly high (it must create systemic risk).

❖The rule can only be overturned by the Council if it finds that it would "put the safety and soundness of the United States banking system or the stability of the financial sector of the United States at risk."

❖The Council will consist of the Treasury Secretary (as Chairman) and the heads of the Fed, OCC, the CFPA, the SEC, the FDIC, the CFTC, the FHFA, and an independent member with insurance expertise named by the President.

❖In the past, Congress wrote consumer laws and gave agencies the authority to adopt regulations to effectuate. Here the CFPA or Bureau has plenary authority to regulate anything it deems "unfair or deceptive." Terribly broad standard.

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Consumer Financial Protection Agency/Bureau

Enforcement authority over banks under $10 billion is quite different in the House bill and the Senate bill.

- House and Senate bill has a $10 billion threshold for CFPA direct supervision and enforcement.
- But in the House bill, smaller banks than $10 billion would still be subject to backup authority by the CFPA/Bureau.
- The Senate bill leaves the small banks solely to the supervision and enforcement of the bank regulators.

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Consumer Financial Protection Agency/Bureau

The CFPA will hold the OTS seat on the FDIC board. A little notice shift with significant ramifications.

Consumer Financial Protection Agency/Bureau

The CFPA will have primary enforcement authority over non-depository institutions if they (1) offer consumer real estate loans or (2) are a "larger participant" in a market for financial products.

Preemption of State Law

The House and Senate bills would both use the Barnett standard for preemption.

- The *Barnett* standard refers, of course, to the 1996 U.S. Supreme Court case that held that the Comptroller is authorized to preempt state law on a case-by-case basis.
- The House language does so with its own language and the Senate language specifically references *Barnett*.
- The Senate bill requires the Comptroller to do this first. Currently, the OCC takes the position that a bank can assess whether a state law is preempted and let it be tested after the fact.

Preemption of State Law

Both the House and Senate bills would overturn the 2007 Watters case that held the bank op subs were covered by preemption.

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Preemption of State Law

The House would permit State AGs to enforce state and federal law against national banks. The Senate bill gives State AGs this authority.

Too Big To Fail Mechanisms

The House bill creates a $150 billion fund to help resolve/prop up failing systemically significant entities.

- Senate bill creates a $50 billion fund.
  - Disparate impact on banks between $50 billion and $100 billion that aren't systemically significant but will be taxed like they are.

    The fund would have a line of credit with the Treasury. Hence, Senator Shelby's description of it as a permanent bailout.

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The Volcker Rule Restrictions

In the Senate bill, unless excused by the Council, the banking agencies are required to issue rules prohibiting proprietary trading or investing in or sponsoring hedge funds or private equity funds.

- This is of limited impact on most banks as a practical matter.
- The House bill is silent on this. And there is a lot of opposition to this provision. Dodd had expressed grave reservations when the Administration raised the proposal late in the process. This may be jettisoned in conference.

De Novo Interstate Branching

The House and Senate bills would permit interstate branching by national banks and insured state-chartered banks.

- Out-of-state de novo branches would be approved in a state chartered bank in that state would have been permitted that branch.
- So far, this provision has been virtually ignored but it is one of biggest changes for a large number of banks, particularly those along state lines.

FDIC Assessments on Assets Rather than on Deposits

The FDIC will have to base its assessments on total consolidated assets minus equity plus its long-term unsecured debt rather than on its deposit assessment base. (The House bill doesn't reduce for long-term unsecured debt.)

This provision will only affect institutions that have non-deposit liabilities less than 57%. This means only the largest banks would be negatively affected. Some major regional banks are in the sixties. But smaller banks are generally higher than this even though some of these banks heavily use FHLB advances.

Question & Answer Session

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