



Insurance, Banks & Financial Services Bulletin



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Bricker & Eckler LLP

100 South Third Street
Columbus, Ohio 43215-4291

Phone 614 . 227 . 2300
Fax 614 . 227 . 2390
info@bricker.com
www.bricker.com

COLUMBUS | CLEVELAND
CINCINNATI-DAYTON

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Financial Services Industry Regulatory Reform: The Administration Proposal

The anticipated Administration proposal for comprehensive reform of the financial services industry regulatory system has been released and contains significant proposed changes for the industry.

While certain aspects of the proposal focus on issues with regard to large “interconnected” financial services providers whose businesses can have “systemic” and global implications, it also provides for a plethora of new and enhanced regulatory oversight requirements and structures impacting all financial services institutions and an entirely new federal bureaucracy to oversee all bank and non-bank consumer financial products and services. Implementation of the proposal would result in a significantly increased regulatory burden for the industry and increased non-revenue-producing cost and expense.

As always, the devil is, and will continue to be, in the details. This is the initial proposal, and time will tell as the proposal makes its way through the legislature and the various agencies. Actual legislative language is expected to be proposed shortly. The proposal is broad and sweeping in its scope and effect, and would impact virtually all participants in the financial services industry.

The basic precepts of the proposal are separated into the following categories as identified by the Administration:

1. “Promote Robust Supervision and Regulation of Financial Firms”

- Federal regulation and supervision of all “large interconnected (financial) firms whose failure could threaten the stability of the system” would be consolidated under the Federal Reserve pursuant to the proposal, regardless of whether the firm owns a depository institution. In addition to banks, virtually all other

financial intermediaries also would be subject to some level of oversight by Treasury and the Federal Reserve. The proposal provides for heightened consolidated Federal Reserve supervision and regulation for “Tier 1 FHCs,” which are identified as those firms “whose failure could pose a threat to financial stability due to their combination of size, leverage and interconnectedness.”

- A new “Financial Services Oversight Council” chaired by Treasury would be created, consisting of representatives of each of the relevant federal agencies, to deal with large-scale policy issues and emerging risks impacting the industry. It would provide a forum for information sharing and coordination of agency responses to policy and agency oversight issues. The Council would include representatives from agencies not presently involved in the Federal Financial Institutions Examination Council including non-bank agencies such as the CFTC and the SEC.
- The federal thrift charter would be eliminated, as would the Office of Thrift Supervision (OTS), and a “National Bank Supervisor” would be established for all federally-chartered institutions. Elimination of the OTS has been anticipated for some time now.
- Increased capital and other enhanced prudential standards would be required for all banks and bank holding companies. The proposal states its support for pending SEC rules regarding shareholder “say on pay” for publicly-traded banks and holding companies. In addition, federal regulators would be directed to issue standards and guidelines for executive compensation packages for all banks and holding companies with a greater focus on long-term value and avoidance of structures that may adversely impact “safe-

Insurance, Banks & Financial Services Group

Faith M. Williams
Chair
614 . 227 . 2374
fwilliams@bricker.com

Jeffery E. Smith
Vice-Chair
614 . 227 . 2352
jsmith@bricker.com

Mark Chilson
614 . 227 . 8826
mchilson@bricker.com

Natalie Trishman Furniss
614 . 227 . 8918
nfurniss@bricker.com

Stephen C. Gray
614 . 227 . 2329
sgray@bricker.com

Robert H. Katz
614 . 227 . 2397
rkatz@bricker.com

Donald R. Keller
614 . 227 . 2341
dkeller@bricker.com

Kevin M. Kinross
614 . 227 . 8824
kkinross@bricker.com

Jeffrey P. McSherry
513 . 870 . 6686
jmcsherry@bricker.com

Quintin F. Lindsmith
614 . 227 . 8802
qlindsmith@bricker.com

Miranda C. Motter
614 . 227 . 4810
mmotter@bricker.com

Terrence O'Donnell
614 . 227 . 2345
todonnell@bricker.com

James G. Petrie
614 . 227 . 2373
jpetrie@bricker.com

Nelson M. Reid
614 . 227 . 8812
nreid@bricker.com

Anne Marie Sferra
614 . 227 . 2394
asferra@bricker.com

Elisabeth A. Squeglia
614 . 227 . 2396
esqueglia@bricker.com

Kurtis A. Tunnell
614 . 227 . 8837
ktunnell@bricker.com

Maggie F. Weber
614 . 227 . 2382
mweber@bricker.com

ty and soundness” concerns.

- Stronger “firewalls” would be required between banks and non-bank affiliates.
- Accounting standards would be reviewed with a focus on “forward-looking loan loss provision practices.”
- Enhanced regulation of the insurance business would be required, and an “Office of National Insurance” would be established within the Treasury.

2. “Establish Comprehensive Regulation of Capital Markets”

- Supervision of securitization markets would be dramatically increased, and originating institutions would be required to retain 5 percent of the credit risk of securitized packages
- Supervision and regulation of OTC derivatives and swaps also would be increased and additional disclosures required.
- Broad and comprehensive new CFTC and SEC regulations impacting the markets for financial instruments are proposed, with a focus on market oversight, stability and early “systemic” problem identification.
- The Financial Services Oversight Council would oversee activities that may pose a threat to “financial stability” on a systemic basis and identify such concerns to other appropriate agencies.
- The Federal Reserve would secure enhanced oversight of payment systems and coordination of payment system issues with other appropriate financial regulators.

3. “Protect Consumers and Investors from Financial Abuse”

- The proposal would provide extensive changes in oversight of “consumer” financial issues and create a new and independent federal Consumer Financial Protection Agency with broad and sweeping powers to closely regulate, supervise and examine bank and non-bank financial institutions with respect to consumer financial products and services.

On the surface, this is perhaps the most problematic of the proposals for the bank and thrift industry as a whole, impacting large, multinational institutions as well as community banks. It would have a far-reaching impact on all financial services industry consumer products, services and regulation.

- The agency would be empowered to dictate certain financial products and services (bank and non-bank), regulate product pricing, enhance

consumer disclosures and impact federal preemption of state consumer laws and regulations. It also would have separate enforcement powers and would be the “primary federal financial consumer protection supervisor.” In addition this new agency also would have authority to dictate extensive new mortgage product regulations and oversight.

- The agency would receive “robust funding” by assessments on the institutions it regulates, including banks and thrifts.
- The proposal would eliminate certain long-standing precepts of federal “preemption,” subjecting multi-state institutions to state laws and regulations in the consumer area.
- The SEC would be provided expanded powers to impose enhanced investor disclosures and establish new “fiduciary duties” for investment firms. The proposal also would expand whistleblower protections and establish “say on pay” requirements for executive compensation plans.

4. “Provide the Government with the Tools it Needs to Manage Financial Crisis”

- The proposal would establish a new “resolution regime” for failing BHCs in addition to the current FDIC process for resolution.
- The proposal would significantly enhance required capital levels for financial holding companies and enhance prompt corrective action procedures in problem situations.
- Expanded cross-agency coordination and resolution authority is also provided in the event that problems arise.

5. “Raise International Regulatory Standards and Improve International Cooperation”

- Citing the interconnectedness of global financial markets, the proposal would increase coordination with financial regulators on an international basis and standardize some aspects of regulation for international providers.

Again, the proposal is the first of what will probably be a long and complex series of proposals, counterproposals and debate over the structure and role of financial regulation in the U.S. in reaction to the current economic concerns.

For more information, please contact Jeff Smith at 614.227.2352 or jsmith@bricker.com.