Improving Financial Stability and Enhancing Prudential Regulation

This legislation --

Creates a Financial Stability Oversight Council to Monitor and Take Actions to Address Systemic Risk:

- The Council will monitor the marketplace to identify potential threats to the stability of the financial system.

Strengthens Regulation and Supervision of Large, Interconnected Financial Firms Reducing the Likelihood of Future Crises:

- The Council will subject financial companies and activities that pose a threat to financial stability to much stricter standards and regulation, including, with respect to companies, higher capital requirements, leverage limits, and limits on concentrations of risk.

Grants Limited Additional Authority to and Increases Accountability of the Federal Reserve

The Federal Reserve will serve as the agent of the Council in regulating systemically risky firms on a consolidated basis and systemically risky activities wherever they occur, ensuring broad accountability for such regulation. The legislation also substantially enhances the authority of the Government Accountability Office (GAO) to examine the Board of Governors of the Federal Reserve and the Federal Reserve Banks to provide greater transparency to Fed facilities and actions.

- **Makes other significant changes to traditional prudential regulation of financial institutions:**
  - **Improved consolidated supervision**. Removes outmoded Gramm-Leach-Bliley Act restraints on the consolidated supervision of large financial companies by the Federal Reserve, and provides specific authority to the Fed and other federal financial agencies to regulate for financial stability purposes and quickly address potential problems.

  - **Provides enhanced regulation for non-banks and closes loopholes.** Places additional safeguards on industrial loan corporations and other non-bank depository institutions, bringing them under a consolidated supervisory framework. Current non-bank banks, ILCs, and similar companies that engage in commercial activities but are not currently subject to bank holding company regulation will not be forced to divest, but their financial activities will be brought under a properly regulated holding company structure for the first time and will face limits on transactions with their commercial affiliates to prevent self-dealing. The bill also closes the ILC loophole going forward, so that no additional commercial companies will be allowed to own banks or ILCs.

- **Consolidates federal bank and thrift regulators while preserving housing-focused savings and loans**. The existing system resulted in a bias toward "lighter touch" regulation and arbitrage among federal bank and thrift regulators. To address this, the bill consolidates the Office of Thrift Supervision with the main federal bank regulator, the Office of the Comptroller of the Currency. However, it preserves the thrift charter for thrifts dedicated to mortgage lending and subjects thrift holding companies to supervision by the Fed to further restrict arbitrage opportunities.

- **Imposes risk retention on all lenders**. For the first time requires lenders to retain a portion of the risk they generate in order to provide real market discipline for underwriting decisions. New rules from the banking regulators and the SEC will require creditors to retain at least 5 percent of the credit risk associated with any loans that are transferred, sold or securitized.

Provides for Tough Restrictions on Assistance in Times of Crisis to Eliminate Government Bailouts.

- The FDIC may extend Emergency Financial Stabilization loan guarantees to solvent banks and predominantly financial companies only in a liquidity crisis. This facility, which will only result in a government payout if a guaranteed loan defaults, will be funded by fees paid by financial companies that request guarantees. A similar facility managed by the FDIC actually generated positive net revenues for the government in the recent liquidity crisis. This authority sunsets on December 31, 2013, unless extended by Congress.

- The Federal Reserve's use of Section 13(3) authority will be subject to significant new restrictions. Use of this authority will require approval by two-thirds of the members of the Council and the consent of the Treasury Secretary after certification by the President that an emergency exists. This authority may not be used to provide assistance to individual companies, and Congress will be able to disapprove further use of the authority.

Dissolution Authority

The bill provides for orderly dissolution of failing firms, ending "Too Big to Fail":

- The legislation provides for robust authority that will enable regulators to dissolve large, highly complex financial companies in an orderly and controlled manner, ensuring that shareholders and unsecured creditors, not taxpayers, bear the losses.

- **No firm will be "too big to fail"** – when a firm enters the dissolution process, management responsible for the failure will be dismissed, parties that should bear losses – particularly shareholders and unsecured creditors – will do so, and the firm will cease as a going concern.

- **The FDIC will be able to unwind a failing firm so that existing contracts can be dealt with and secured creditors' claims can be addressed.** However, unlike traditional bankruptcy, which does not account for complex interrelationships of such large firms and may endanger financial stability, this process will help prevent contagion and disruption to the entire system and the overall economy.

- **Dissolution costs will be repaid first from the assets of the failed firm at the expense of shareholders and creditors, and any shortfall will be repaid by assessments on all large financial firms.** In this instance the bill follows the "polluter pays" model where the financial industry pays for its mistakes—not taxpayers.

- **There are no bailouts for failing institutions**. If financial assistance is necessary for orderly dissolution, industry will pay for it:
  - A Systemic Dissolution Fund can be used to help wind down failing financial institutions, but not to preserve them. The Fund will be pre-funded by assessments on financial companies with more than $50 billion in assets and by hedge funds with more than $10 billion in assets. This authority sunsets on December 31, 2013, unless extended by Congress.