TITLE I: Financial Stability

A. Introduction

Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") seeks to increase financial marketplace transparency and stability by establishing a Financial Stability Oversight Council (the "Council") focused on identifying and monitoring systemic risks posed by financial firms and by financial activities and practices. It establishes a new regulatory and supervisory framework for "large, interconnected" banking organizations and certain nonbank financial companies. By a two-thirds vote, the Council can determine which U.S. and foreign nonbank financial companies that are predominantly engaged in financial activities (together "NBFCs") are to be subject to enhanced supervision ("Supervised NBFCs") by the Board of Governors of the Federal Reserve (the "Fed"), based on the perceived risk a company poses to financial stability in the United States. Empowering the Fed to implement this regime substantially enhances its powers and responsibilities.

The Act also contains an "anti-evasion" provision that allows the Council to designate for Fed supervision a company that is not an NBFC and thus cannot be designated a Supervised NBFC. If the Council determines such a company is "organized or operates in such a manner as to evade" the application of Title I, and engages in financial activities that meet the criteria for designation, those activities can be placed under Fed supervision under Title I. Title I provides for an intermediate holding company ("IHC") structure, subject to implementation by the Fed, so that the Fed can regulate such "evasion" activities and the financial activities of NBFCs, while leaving commercial and other nonfinancial activities outside this new regulatory regime.

Only bank holding companies ("BHCs")[1] with over $50 billion in consolidated assets are

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[1] Note that Title I defines the term "bank holding company" to have the same meaning as in the Bank Holding Company Act of 1956 (the "BHC Act") and also specifies that a foreign bank or company that is treated as a BHC for purposes of the BHC Act pursuant to Section 8(a) of the International Banking Act of 1978 (the "IB Act") is also to be treated as a BHC. **Sec. 102(a) (p. 17)**. Note that this is the same definition used throughout the Act, including with regard to the definition of "banking entities" as used in the Volcker Rule discussions. Note that Section 8(a) of the IB Act provides that "(1) any foreign bank that maintains a branch or agency in a State, (2) any foreign bank or foreign company controlling a foreign bank that controls a commercial lending company organized under State law, and (3) any company of which any foreign bank or company referred to in (1) and (2) is a subsidiary shall be subject to the provisions of the Bank

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subject to more stringent prudential standards and reporting requirements under Title I. All bank holding companies would be subject to Fed supervision under the Bank Holding Company ("BHC") Act , which is enhanced by various provisions of Title VI. Title I also includes the minimum holding company capital requirements added by and amendment offered by Senator Collins (R-ME) ("Collins Amendment"). In addition, a new Office of Financial Research in the Treasury Department would provide the Council with technical expertise and data collection support services.

Under Title I, the Fed will be responsible for establishing "more stringent" prudential standards than would apply to the Supervised NBFCs and to BHCs with assets of at least $50 billion ("Title I Companies"). It can also tailor requirements for these firms. The Fed has the authority to require reports from and conduct examinations of these companies, as well as apply early remediation requirements in the case of a company experiencing financial distress. If the Fed determines that such a large, complex company poses a grave threat to the financial stability of the United States, with a two-thirds vote of the Council it could require such company to take mitigatory action such as divesting subsidiaries, selling assets, or limiting activities.

The Council's authority is somewhat restricted compared to what it would have been under the House Bill, H.R. 4173. For example, under the final Act, most significant actions by the Council, such as subjecting a NBFC to the Fed's supervision, require a two-thirds vote including the affirmative vote of the Secretary of the Treasury (the "Secretary"), rather than a simple majority. Further, under H.R. 4173, the Council would have had the potential authority to subject any BHC to stricter prudential regulations if it was deemed necessary to mitigate risk to the financial system, not just those with assets greater than $50 billion.

Note that the effective dates FOR ALL PROVISIONS OF THE ACT is one day after date of enactment, unless otherwise specified. Sec. 4 (p. 16).

B. Highlights

1. The Council will recommend prudential standards "more stringent" than currently applicable to BHCs and NBFCs generally, including capital, liquidity, resolution plan, and risk-management standards, for Supervised NBFCs and "large, interconnected" BHCs (generally at least $50 billion in assets), to be implemented by the Fed. The Fed is to implement these standards through regulations within 18 months of enactment, but has discretion to act more quickly.

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Holding Company Act." Thus, while Section 8(a) of the IB Act does not "treat as a bank holding company" such foreign banks, it does "subject" them to the BHC Act.

2. A firm that is not a BHC and derives at least 85% of its consolidated revenues or assets from "financial" activities is a NBFC. A NBFC is only subject to regulation if the Council designates it as a Supervised NBFC based upon statutory factors. Under an "evasion" provision, financial activities of other companies may be subjected by the Council to prudential supervision under Title I.

3. The Fed can require any Supervised NBFC or any company subject to an evasion determination to establish an IHC for financial activities; an IHC established pursuant to an "evasion" determination will be a Supervised NBFC regulated by the Fed.

4. The stringency of these new standards is to increase based upon factors set forth in Title I. The title also provides that, based on Council recommendations, the Fed may tailor the stringency of the Title I standards applicable to each BHC or Supervised NBFC under this regime; the Fed also can limit expansion and potentially risky activities.

5. The Collins Amendment requires capital rules for depository holding companies applying standards that are "not less than" the minimum generally-applicable capital standards for banks, thus excluding trust preferred securities. These requirements will be phased in over approximately five years; an exclusion for smaller companies is provided.

6. *Effective Date*. Under Title I, the Council is created on the date of enactment and is to meet quarterly. Title I does not specify when the Council is to make determinations regarding firms to be Supervised NBFCs or to make its recommendations regarding heightened standards. The Fed is responsible for implementing the more stringent prudential standards under Title I. It must adopt such regulations within 18 months of the effective date. The Collins Amendment concerning capital standards takes effect for affected companies when the Fed adopts implementing rules, but includes a phase-in of approximately five years.

C. Summary

1. The Financial Stability Oversight Council

a. Formation of the Council

The Council is established on the date of enactment of the Act. **Sec. 111(a) (p. 18)**.

b. Structure of the Council

Chaired by the Secretary, the Council is composed of 8 other "voting members" that are federal financial regulators,[2] an independent member with insurance expertise, and 5 nonvoting members.[3] The Council is required to meet no less frequently than quarterly and shall take action by majority vote unless otherwise required. **Sec. 111(e)-(f) (p. 20)**.

c. Council Authority

The Council is responsible for identifying and responding to emerging risks throughout the financial system. ***See*** **Sec. 112(a) (p. 20)**. The Council's responsibilities fall into three categories. First, the Council's broad mandate includes identifying both risks to the financial stability of the United States that could arise from the material financial distress or failure of large, interconnected BHCs and NBFCs, or that could arise outside the financial services marketplace. **Sec. 112(a)(1)(A) (p. 20)**. Second, the Council is to promote market discipline by eliminating the expectation on the part of shareholders, creditors, and counterparties that the Government will shield them from losses in the event of failure. **Sec. 112(a)(1)(B) (p. 20)**. Third, the Council is to respond to emerging threats to U.S. financial stability. **Sec. 112(a)(1)(C) (p. 21)**.

d. Council Duties

Title I sets forth a list of 14 separate duties to be performed by the Council, as follows:

i. Together with the Office of Financial Research (the "Office") (discussed in greater detail herein), collect information from

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[2] In addition to the Secretary of the Treasury as Chair, the members include the Chairmen of the Fed, the FDIC, SEC, CFTC, and NCUA, the Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, the Director of the Federal Housing Finance Agency, and an independent member with insurance expertise appointed by the President.

[3] The nonvoting members of the Council are the Director of the Office of Financial Research, the Director of the Financial Insurance Office, a State insurance commissioner, a State banking supervisor, and a State securities commissioner. **Sec. 111(b)(2) (p. 19)**. Nonvoting members are not to be excluded from any proceedings of the Council except that the Chairperson may (on the vote of the member agencies) exclude them when needed to safeguard and promote the free exchange of confidential supervisory information. **Sec. 111(b)(3) (p. 19)**.

member agencies, other regulators, BHCs and NBFCs;

ii. Direct the Office to perform research and analysis on data in support of the Council;

iii. Monitor the financial services marketplace to identify potential threats to U.S. financial stability;

iv. Monitor domestic and international financial regulatory proposals and developments, including insurance and accounting issues, and advise Congress and make recommendations that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets;

v. Facilitate information sharing and coordination among the member agencies and other federal and state agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions;

vi. Recommend general supervisory priorities and principles reflecting the outcome of discussions among the member agencies;

vii. Identify gaps in regulation that could pose risks to U.S. financial stability;

viii. Require supervision by the Fed for NBFCs that may pose risks to U.S. financial stability in the event of their material financial distress or failure, or because of their activities;

ix. Make recommendations to the Fed concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for Supervised NBFCs and large, interconnected BHCs;

x. Identify systemically important financial market utilities and payment, clearing, and settlement activities (as defined in Title VIII);

xi. Make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among BHCs, NBFCs, and U.S. financial markets;

xii. Review and (at the Council's discretion) submit comments to the SEC and any standard-setting body with respect to an existing or

proposed accounting principle, standard, or procedure;

xiii. Provide a forum for discussion and analysis of emerging market developments, financial regulatory issues, and the resolution of jurisdictional disputes among the members of the Council; and

xiv. Annually report to and testify before Congress on the activities of the Council, significant financial market and regulatory developments, potential emerging threats to U.S. financial stability, all determinations made under Section 113 or Title VIII, all recommendations made under Section 119, and recommendations to U.S. financial markets, to promote market discipline, and to maintain investor confidence. **Sec. 112(a) (pp. 21-22)**.

e. Statements by Council Members

The Chairperson of the Council is required to appear before the House Financial Services and Senate Banking committees each year and discuss the efforts, activities, objective and plans of the Council. **Sec. 112(c) (p. 22)**. In addition, Title I requires that each Council member make an annual statement as to whether the Council is doing its job. At the time each annual report of the Council is submitted to Congress, each voting member of the Council is required to submit a signed statement to Congress stating whether such member believes the Council, Government and private sector are taking all reasonable steps to ensure financial stability and mitigate systemic risk and, if the member does not believe all reasonable steps are being taken, to state what actions the member believes should be taken. **Sec. 112(b) (p. 22)**.

f. Information Gathering

Title I grants the Council authority to obtain information from the Office, member agencies, and the Federal Insurance Office (the "FIO"). **Sec. 112(d) (p. 22)**. In addition, the Council, through the Office, can require the submission of periodic and other reports from NBFCs and BHCs, but must mitigate this reporting burden by coordinating with the company's primary financial regulatory agency and rely on information available from such agencies. In addition, in the case of foreign financial companies, the Council is required to mitigate the reporting burden by consulting with the appropriate foreign regulators and rely on information already conducted by them. **Sec. 112(d)(2) and (3) (p. 23)**.

2. Examination by the Fed

If the Council is unable to determine whether the financial activities of a U.S. NBFC pose a threat to U.S. financial stability based on information or reports obtained by it, then the Council may request the Fed, and the Fed is authorized, to conduct an examination of the U.S. NBFC for the sole purpose of determining whether it should be supervised by the Fed. **Sec. 112(d)(4) (p. 23)**.

3. GAO Audit of Council

The Comptroller General may audit the activities of the Council and any person acting under its authority and, if it does so, then the Comptroller General will have access to information of the Council including any records or other information under its control or used by it, any records or other information under the control of a person or entity acting on the Council's behalf, and officers, directors, employees, financial advisors, staff, working groups, and agents and representatives of the Council. **Sec. 122 (pp. 37-38)**.

D. Nonbank Financial Companies

1. Definition of Nonbank Financial Company

Title I establishes a threshold definition for an NBFC—as a company that derives at least 85% of its annual gross revenue or consolidated assets from financial activities (as defined in Section 4(k) of the BHC Act), including any depository institutions. Only certain, systemically-significant (as determined by application of the factors listed below) NBFCs will be subject to regulation by the Fed. **Sec. 102(a)(4) (p. 21) and Sec. 102(a)(6) (p. 22)**.

This definition of NBFC includes domestic and foreign firms. A NBFC can either be a Foreign Nonbank Financial Company (defined in Section 102(a)(4)(A) (p. 17) as companies organized outside of the United States) or a U.S. NBFC (defined in Section 102(a)(4)(B) (p. 17) as companies organized under U.S. or any State law). In either case the entity must be "predominantly engaged in" financial activities. "Predominantly engaged" is defined in Sec. 102(a)(6) to mean that either the annual gross revenues of it and all of its subsidiaries are derived from activities that are financial in nature (as defined in BHC Act Section 4(k)) and from the ownership or control of insured depository institutions represent 85% or more of the company's consolidated annual gross revenue[4] or that the consolidated assets of the company and all of its subsidiaries related to Section 4(k) activities and the ownership or control of insured depository institutions represents 85% or more of the consolidated assets of the company.[5] **Sec. 102(a)(6)**

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[4] Note that this definition reflects that activities defined in Section 4(k) of the BHC Act do not including "banking activities" and thus that it is necessary to list banking activities as a financial activity separately. This is a change—and an improvement—over some earlier versions of the legislation which failed to recognize or omitted this distinction.

[5] Note that because different categories of assets generate different revenue yields, applying an 85% test to both the balance sheet and income statement items will yield different results. Since this is an "or" test rather than an "and" test the result is a broader

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(p. 18). The Fed is directed to establish regulations setting the requirements for determining if a company is "predominantly engaged" in financial activities. **Sec. 102(b) (p. 18)**.

The sub-definitions of "Foreign NBFC" and "U.S. NBFC" are noteworthy because while both are "NBFCs," they each exclude certain classes of companies. "Foreign NBFCs" specifically do not include companies that are or are treated as BHCs in the United States. "U.S. NBFCs" exclude BHCs and also exclude Farm Credit System institutions, national securities exchanges (or a parent of one), clearing agencies (or parent of one), security-based swap execution facilities (or security-based swap data repositories registered with the SEC), boards of trade designated as a contract market (or parent of one), derivatives clearing organizations (or parent of one), or swap execution facilities (or swap data repositories registered with the CFTC). Note that these carve outs have particular impact in specific titles of the Act, including in Title VII regulating derivatives.

2. Supervised NBFCs

The Council "may" determine, by a two-thirds vote of its members, which U.S. NBFCs will become Supervised NBFCs subject to the Title I regime. In making this determination, the Council must consider the following factors:

i. The extent of leverage of the company;

ii. The extent and nature of the off-balance-sheet exposures of the company;

iii. The extent and nature of the transactions and relationships of the company with other significant NBFCs and significant BHCs;

iv. The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the U.S. financial system;

v. The importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;

vi. The extent to which assets are managed rather than owned by the

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definition of NBFC. In some earlier versions of the legislation only a revenue test was proposed.

company, and the extent to which ownership of assets under management is diffuse;

vii. The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

viii. The degree to which the company is already regulated by one or more primary financial regulatory agencies;

ix. The amount and nature of the financial assets of the company;

x. The amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

xi. Any other risk-related factors the Council deems appropriate. **Sec. 113(a)(2) (p. 24)**.

The Council may make the same determination with regard to Foreign NBFCs, except that the considerations it is required to take into account generally relate to the U.S. operations of the company—including the effect on underserved communities in the United States and the amount and nature of financial assets in the United States. ***See*** **Sec. 113(b) (p. 25)**.

3. Anti-evasion

Under an "anti-evasion" provision, the Council has discretion to determine (on its own initiative or at the request of the Fed, and by a two-thirds vote including the vote of the Chairperson) that with regard to any "company incorporated or organized under the laws of the United States or any State or the financial activities in the United States of a company incorporated or organized in a country other than the United States," such company's "nature, scope, size, scale, concentration, interconnectedness, or mix of" financial activities conducted directly or indirectly by it would pose a threat to U.S. financial stability. In that case, the Council can find that it operates in a manner that evades application of Title I and subject the company to Fed supervision and prudential standards. **Sec. 113(c) (pp. 25-26)**.

Under this provision the Council has discretion to subject financial activities of a company that is not "predominantly financial" to prudential standards and Fed supervision under Title I. It would appear that the requirement that the company is "organized or operates in a manner so as to evade" the application of Title I could be read to mean that the activity is not conducted in what under the title is defined as a NBFC. **Sec. 113(c) (pp. 25-26)**. After the Council determination under this provision, then the company may on its own establish an IHC

in which "the financial activities of such company and its subsidiaries shall be conducted."[6] This IHC is then subject to Fed supervision and to prudential standards as if it were a Supervised NBFC. In addition, the Fed may require that the company establish an IHC in order to facilitate the supervision of the financial activities of the company, in which case, again, the IHC will be a Supervised NBFC subject to Fed supervision and prudential standards. **Sec. 113(c)(3) (p. 26)**.

Note that only the "financial activities" of a company subject to the anti-evasion provision are subject to prudential supervision.[7] Nonfinancial activities "shall not" be subject to Fed supervision. **Sec. 113(c)(6) (p. 27)**. This provision applies only to "the company" subject to a anti-evasion determination by the Council, meaning that the company is not a NBFC. However, there is tension between this broad statement and the fact that Supervised NBFC are treated differently in that a Supervised NBFC may have up to 15% of its assets or revenues derived from nonfinancial activities.

4. Opportunities To Rescind or Appeal a Council Decision

A determination by the Council that a NBFC is to be supervised by the Fed (but apparently not a decision to subject a company that is not a NBFC to an anti-evasion determination and supervision) may be reevaluated by the Council or appealed by the company. The Council is required to reevaluate its decisions to subject a NBFC to Fed supervision at least annually, and to rescind the decision by a two-thirds vote of members including the Chairperson where the Council determines the NBFC no longer meets the standards for Fed supervision. **Sec. 113(d)(p. 27)**. In addition, the Council must provide a NBFC written notice of a proposed determination to subject it to Fed supervision, in which case the NBFC has 30 days to request in writing a written or oral hearing to contest the proposed determination, and after receipt of which the Council must fix a hearing time and place that is not later than 30 days after the date it received the request. Within 60 days of the hearing, the Council must notify the NBFC of its final decision. If the NBFC did not request a hearing then the Council must notify the NBFC of its determination within 10 days of the date by which the company could have requested a hearing. **Sec. 113(e) (pp. 27-28)**.

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[6] Note that activities described in Section 167(b)(2) of the Act need not be conducted in the IHC.

[7] The term "financial activities" is defined, in this context, to mean activities of a financial nature as defined in Section 4(k) of the BHC Act and ownership or control of insured depository institutions, but for this purpose excludes internal financial activities conducted for the company or an affiliate, including internal treasury, investment, and employee benefit functions. **Sec. 113(c)(5) (pp. 26-27)**.

5. Emergency Designation

The Council is permitted to waive the notice and hearing requirements if it determines by a two-thirds vote (including the Chairperson) that waiver is needed to prevent or mitigate threats posed by the NBFC to U.S. financial stability. In this case the Council is required to give the NBFC notice of the waiver within 4 hours after it is granted. If the NBFC is a foreign NBFC, then the Council is required to consult with the company's home country supervisor. In either case, the Council must give the NBFC an opportunity to request a hearing to contest the waiver or modification within 10 days of the date the notice of waiver was provided to the NBFC. In that case the Council has 15 days after the date of receipt of the request to set a hearing and must notify the NBFC of its final determination within 30 days of the hearing. **Sec. 113(f) (p. 28)**.

6. Judicial Review

A final determination by the Council is not the last opportunity for a NBFC to contest the Council's action. A NBFC has 30 days after the receipt of a final determination to bring an action in a U.S. district court either in the judicial district where the home office of the NBFC is located or in the U.S. District Court for the District of Columbia (the "Court") for an order requiring that the final determination be rescinded. The Court's options are limited to two: it is required to either dismiss the action or direct the final determination to be rescinded. The standard of review for the court is whether the Council's decision was "arbitrary and capricious"—a very high standard for any NBFC to satisfy. **Sec. 113(h) (pp. 28-29)**.

7. Safe Harbor

The Fed must issue regulations in consultation with the Council setting criteria for exempting certain types of U.S. and foreign NBFCs from Fed supervision. **Sec. 170(a) (p. 61)**. In developing criteria under this section, the Fed must take into account the criteria used for determining whether to subject a NBFC to Fed supervision. **Sec. 170(b) (p. 61)**. The Fed, in consultation with the Council, must review the regulations used to exempt NBFCs from supervision at least once every five years, but such revisions will not take effect for two years from their date of publication. **Sec. 170(d) (p. 62)**. The Chairman of the Fed and the Chairperson of the Council must submit a joint report to Congress within 30 days of the date final regulations are issued (or revisions are subsequently issued) that explains the rationale for exemption. **Sec. 170(e) (p. 62)**.

8. Supervised NBFC Registration

Within 180 days of being designated by the Council as a Supervised NBFC, the company must register with the Fed on forms prescribed by the Fed. **Sec. 114 (p. 28)**.

9. Enforcement Against Supervised NBFCs

A Supervised NBFC and any subsidiaries (other than a depository institution subsidiary) is subject to Sections 8(b) through (n) of the Federal Deposit Insurance Act ("FDI Act") as if it were a BHC. **Sec. 162(a) (p. 48)**. If the Fed determines a practice of a depository institution subsidiary or functionally regulated subsidiary of a Supervised NBFC poses a threat to U.S. financial subsidiary or does not comply with Fed regulations, it may recommend in writing that

the primary financial regulatory agency for the subsidiary initiate action or enforcement proceedings. **Sec. 162(b)(1) (p. 48)**. If the primary regulator fails to take acceptable action within 60 days of the date of the recommendation, then the Fed (upon a vote of its members) may take the recommended supervisory or enforcement action as if the subsidiary were a BHC. **Sec. 162(b)(2) (p. 48)**.

10. Reports By and Examinations Of Supervised NBFCs

Reports. The Fed may require any Supervised NBFC (and any of its subsidiaries) to submit reports to keep the Fed informed as to the financial condition of the company, systems of the company for monitoring and controlling risks, and the extent to which activities post a threat to U.S. financial stability. **Sec. 161(a)(1) (p. 47)**. The Fed is required to use existing reports and supervisory information provided to federal and state regulators, audited financial statements, and other publicly available information to the fullest extent possible. **Sec. 161(a)(2) (p. 47)**.

Examinations. The Fed may examine any Supervised NBFC and any subsidiary to inform the Fed of the nature and operations of the company; the financial, operational, and other risks the company may pose to U.S. financial stability or the safety and soundness of the company; systems for monitoring risks; and compliance with law. **Sec. 161(b)(1) (p. 47)**. The Fed is required to use the reports of examinations of any subsidiary depository institution or functionally regulated subsidiaries to the fullest extent possible. **Sec. 161(b)(2) (pp. 47-48)**.

11. Management Interlocks Prohibition

Supervised NBFCs will also be treated as a BHC for purposes of the Depository Institutions Management Interlocks Act, and the Fed may not grant waivers for interlocks involving Supervised NBFCs and BHCs over $50 billion. **Sec. 164 (p. 49)**.

E. Stricter Prudential Regulation by the Fed

1. Risk Mitigation Standards

The Fed, on its own or based on Council recommendations (under Section 115), is required to establish prudential standards for Title I Companies.[8] The purpose is to prevent or mitigate risks to U.S. financial stability that could arise from the material distress or failure, or from the ongoing activities, of these large, interconnected financial institutions. **Sec. 165(a)(1)**

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[8] The Council may recommend that this asset threshold be made higher than $50 billion for the application of any individual standard applied by the Fed. **Sec. 115(a)(2)(B) (p. 29)**. The Council has authority to adjust this threshold above $50 billion pursuant to such a Council recommendation. **Sec. 165(a)(2)(B) (p. 50)**.

(p.50). For the same purpose, the Council "may" make recommendations to the Fed concerning establishing and refining prudential standards and reporting and disclosure requirements applicable to Title I Companies. **Sec. 115(a)(1) (p. 29)**.

The parallel nature of Section 115 and Section 165 of the Act reflect that the Council does not have direct regulatory authority itself, and for this reason is limited to making recommendations to the Fed regarding the "more stringent" prudential standards. In making these recommendations, the Council may differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including of their subsidiaries), size, and any other factors the Council deems appropriate. **Sec. 115(a)(2) (p. 29)**. In addition, the prudential standards recommended by the Council may include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits, and overall risk management requirements. **Sec. 115(b)(1) (pp. 29-30)**.

2. Heightened Standards Applicable to Activities or Practices

Council Recommendations. Title I provides for applying heightened standards to activities or practices, as opposed to companies. The Council may also provide for more stringent regulation of a specific financial activity by issuing recommendations to the primary financial regulatory agencies to apply heightened standards for a financial activity or practice conducted by BHCs or NBFCs if the Council determines the activity could increase risk of significant liquidity, credit, or other problems spreading among BHCs and NBFCs; U.S. financial markets; or low-income, minority, or underserved communities. **Sec. 120(a) (p. 35).**

Consultation and Costs. The Council must consult with the primary financial regulator and provide public notice and opportunity to comment on any proposed recommendation that the primary financial regulator apply heightened standards for a financial activity or practice. The heightened standards must take costs to long-term economic growth into account and may include either prescribing the conduct of the activity only in specific ways or prohibiting the activity entirely. **Sec. 120(b) (p. 35)**.

Imposition of Standards. Each primary financial regulatory agency must impose the standards recommended by the Council or explain in writing to the Council within 90 days of the date the Council issues the recommendation why the agency has not followed the recommendation of the Council. **Sec. 120(c) (pp. 35-36)**.

Reports to Congress. The Council must report to Congress on any recommendations it issues to apply heightened standards to individual activities or practices, whether the primary financial regulatory agency implemented the recommendations, and any recommendations for legislation. **Sec. 120(d) (p. 36)**.

Rescission and Appeal. The Council may recommend to the primary financial regulatory agency that its recommendation that a financial activity or practice be subject to standards or safeguards be rescinded, but it is up to the primary financial regulatory agency to determine whether the standard should remain in effect. Each primary financial regulatory agency must

establish procedures under which entities under its jurisdiction can appeal a determination to apply heightened standards to an activity or practice. **Sec. 120(e) (p. 36)**.

3. More Stringent and Increasingly Stringent

The Fed is required to ensure that the prudential standards applied to Title I Companies are "more stringent" than the standards applicable to NBFCs and BHCs that do not present similar risks to the financial stability of the United States, and the Council may make recommendations regarding these prudential standards to the Fed. **Sec. 165(a)(1)(A) (p. 50) and Sec. 115(a)(1)(A) (p. 29)**. In addition, the Fed must apply increasingly stringent prudential standards as Title I Companies become increasingly large, complex, and risky. **Sec. 165(a)(1)(B) (p. 50)**. These standards are to increase in stringency based on:

i. The extent of the leverage of the company;

ii. The extent and nature of off-balance-sheet exposures;

iii. The extent and nature of transactions and relationships with other significant NBFCs and significant BHCs;

iv. The importance of the company as a source of credit for low-income, minority, or underserved communities and the impact of failure on such communities;

v. The extent to which assts are managed rather than owned and the extent to which owned assets are diffuse;

vi. The nature, scope, size, scale, concentration, interconnectedness, and mix of activities;

vii. The degree to which the company is already regulated;

viii. The amount and nature of the financial assets of the company;

ix. The amount and types of liabilities of the company and reliance on short-term funding;

x. Whether the company owns an insured depository institution;

xi. The nonfinancial activities and affiliates of the company; and

xii. Any other risk-related factors the Fed deems appropriate. **Sec. 115(a)(1)(B) (p.29), Sec. 165(a)(1)(B) (p. 50), Sec. 115(b)(3) (p. 30), and Sec. 165(b)(3) (p. 51)**.

4. Stability

Both the Council and the Fed are required to ensure that small changes in the factors impacting these prudential standards to do not result in "sharp, discontinuous" changes in the

standards. **Sec. 115(b)(3)(B) (p. 30) and Sec. 165(b)(3)(B) (p. 51)**.

5. Tailored Application

The Fed must apply increasingly stringent prudential standards, which may be differentiated among companies on an individual basis or by category, taking into account the following considerations:

i. Capital structure;

ii. Riskiness;

iii. Complexity;

iv. Financial activities (including of subsidiaries);

v. Size; and

vi. Any other risk-related factors the Fed deems appropriate. **Sec. 165(a)(2)(A) (p. 50)**.

6. Development of Prudential Standards

The Fed must establish prudential standards that include:

i. Risk-based capital requirements and leverage limits (unless the Fed determines other standards are more appropriate);

ii. Liquidity requirements;

iii. Overall risk management requirements;

iv. Resolution plan and credit exposure report requirements; and

v. Concentration limits. **Sec. 165(b)(1)(A) (pp. 50-51)**.

In addition, the Fed may, at its discretion, establish additional prudential standards that include:

i. Contingent capital requirements;

ii. Enhanced public disclosures;

iii. Short-term debt limits; and

iv. Other prudential standards that the Fed determines necessary or the Council recommends to the Council (under Section 115). **Sec. 165(b)(1)(B) (p. 51)**.

7. Foreign Financial Companies

In making recommendations that would apply to foreign nonbank financial companies supervised by the Fed or foreign-based BHCs, the Council is to give due regard to principles of national treatment and competitive equity. The Fed is to give the same due regard to principles of national treatment and competitive equity in applying these standards. **Sec. 165(b)(2) (p. 51)**.

Note also that, as a general matter, for purposes of the application of the subtitles related to the authority of the Council (Section 111 through Section 123) and related to the authority of the Fed over NBFCs and BHCs (Section 161 through Section 176), that (other than in Section 113(b)) with respect to a foreign NBFCs, the Act covers only the United States activities and subsidiaries of such foreign companies. **Sec. 102(c) (p. 18)**. Section 113(b) provides that the Council may (by a two-thirds vote including the Chairperson) determine that a foreign NBFC is to be supervised by the Fed and subject to prudential standards (because material financial distress of the company and its nature, scope, size, scale, concentration, interconnectedness, or mix of activities could threaten United States financial stability). **Sec. 113(b) (p. 25)**. Thus, while all of the activities of a foreign NBFC are to be considered in determining whether the foreign company poses a risk to U.S. financial stability (and should therefore be supervised by the Fed), only the activities of the company in the United States and those conducted by its U.S. subsidiaries will be regulated.

8. Contingent Capital

After submission of a report to Congress of a study conducted by the Council, the Fed may adopt contingent capital requirements for Title I Companies designed to "maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress." **Sec. 165(c)(1) (p. 52)**. In issuing these regulations the Fed must consider the Council's report, an appropriate transition period for implementing contingent capital, all the considerations going into prescribing tailored prudential standards, the entity's capital requirements, and any other factors the Fed deems appropriate. **Sec. 165(c)(2) (p. 52)**.

The Council is required to conduct a study—and report to Congress within 2 years of enactment—of the feasibility, benefits, costs and structure of a contingent capital requirement on Supervised NBFCs and large, interconnected BHCs. The study is to include an evaluation of the degree such requirements would enhance safety and soundness, promote U.S. financial stability, and reduce risks to U.S. taxpayers. It must also evaluate the characteristics and amounts of contingent capital to be required, analyze potential prudential standards that should be used to determine whether contingent capital would be converted to equity in times of financial stress, evaluate the cost to companies and the effects on the financial markets of requiring contingent capital, and evaluate the effects on international competitiveness of companies subject to the requirement. **Sec. 115(c) (pp. 30-31)**.

9. Resolution Plans and Credit Exposure Reports

Resolution Plans. The Fed must require all Title I Companies to prepare orderly resolution plans, sometimes called a "living will," to plan for the event of material financial distress or failure. Each such plan must include:

i. Information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

ii. Full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company; identification of the cross-guarantees tied to different securities; identification of major counterparties; and a process for determining to whom the collateral of the company is pledged; and

iii. Any other information that the Fed and the FDIC jointly require by rule or order. **Sec. 165(d)(1) (p. 52)**.

Credit Exposure Reports. The Fed must also require that each Title I Company submit a periodic report to the Fed, Council and FDIC on the nature and extent to which the company has credit exposure to other significant NBFCs and significant BHCs and also the nature and extent to which other significant NBFCs and BHCs have credit exposure to it. **Sec. 165(d)(2) (P. 53)**.

Each orderly resolution plans and credit exposure reports will be reviewed by the Fed and FDIC. **Sec. 165(d)(3) (p. 53)**. If these agencies jointly determine that a resolution plan of a Title I Company is not credible or would not facilitate an orderly resolution of the company in bankruptcy, then the Fed and FDIC must notify the company of the deficiencies and the company must revise and resubmit the plan. **Sec. 165(d)(4) (p. 53)**. If a re-submitted plan is not viewed as credible by these agencies, they may impose requirements or restrictions on capital, leverage, liquidity, growth, or operations. **Sec. 165(d)(5)(A) (p. 53)**.

Divestiture. In addition, the Fed and the FDIC, in consultation with the Council, may jointly direct a Title I Company to divest assets or operations in order to facilitate an orderly resolution in the event of failure if the Fed and FDIC have jointly imposed more stringent requirements on the company and the company has failed, within 2 years, to resubmit a resolution plan with the required revisions. **Sec. 165(d)(5)(B) (pp. 53-54)**.

The Fed and FDIC must issue regulations implementing this provision within 18 months of enactment. However, the statute does not specify when resolution plans must be first submitted. **Sec. 165(d) (p. 52)**. Also, note that the Council "may" make recommendations to the Fed concerning the requirement that a Title I Company report periodically on their plans for rapid and orderly resolution in the event of material financial distress or failure. **Sec. 115(d) (pp. 31-32)**.

10. Concentration Limits

The Fed is required to adopt regulations limiting the credit exposure of Title I Companies to an unaffiliated firm to 25% of capital stock and surplus, unless the Fed prescribes a lower percentage. A transaction between a covered company and any person is a transaction with the covered company if the proceeds of the transaction benefit, or are transferred to, that company. A transition period of three years (which the Fed may extend for 2 additional years) from the date of enactment applies. In addition, the Fed may grant exemptions. **Sec. 165(e) (p. 54)**. Note

that the Council "may" make recommendations to the Fed concerning the standards to limit concentration risk for Title I Companies. **Sec. 115(e) (p. 32)**. For purposes of this provision, "credit exposure" is broadly defined and means:

i. All extensions of credit to the company, including loans, deposits, and lines of credit;

ii. All repurchase agreements and reverse repurchase agreements with the company, and all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the Title I;

iii. All guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of the company;

iv. All purchases of or investment in securities issued by the company;

v. Counterparty credit exposure to the company in connection with a derivative transaction between the Title I Company and the company; and

vi. Any other similar transactions that the Fed, by regulation, determines to be a credit exposure. **Sec. 165(e)(3) (pp. 54-55)**.

11. Enhanced Public Disclosures

The Fed may prescribe periodic public disclosures for Title I Companies to "support market valuation of the risk profile, capital adequacy, and risk management capabilities" of the company. **Sec. 165(f) (p. 55)**.

The Council may make recommendations to the Fed to require periodic public disclosures by Title I Companies in order to support market evaluation and risk profile, capital adequacy, and risk management capabilities. **Sec. 115(f) (p. 32)**.

12. Short-Term Debt Limits

The Fed <u>may</u>, by regulation, prescribe a limit on the amount of short-term debt, including off-balance sheet exposures, that may be accumulated by Title I Companies. **Sec. 165(g) (p. 55).** The Council may make recommendations to the Fed to require short-term debt limits to mitigate risks that an over-accumulation of such debt could pose a risk to such companies or the financial system. **Sec. 115(g (p. 32)**. Such limit must be based on the short term debt of the company as a percentage of the capital stock and surplus of the company. **Sec. 165(g)(2) (p. 55)**. For this purpose, "short-term debt" is defined to mean liabilities with short-dated maturities that the Fed identifies by regulation, and excluding any insured deposits. **Sec. 165(g)(3) (p. 55)**. The Fed has both rulemaking and exemption granting authority with regard to the imposition of short-term debt limits. **Sec. 165(g)(4) and (5) (p. 56)**.

13. Risk Committee

Each Supervised NBFC that is publicly traded will be required to establish a risk committee within 1 year of the date it receives notice that it is supervised by the Fed. BHCs that are publicly traded and have consolidated assets of $10 billion or more must also establish a risk committee. The Fed may, at its discretion, require that BHCs that are publicly traded and have less than $10 billion in assets establish a risk committee. The risk committee is required to oversee the financial institution's risk management practices, include a number of independent directors determined by the Federal Reserve, based on the nature of operations, size of assets and other criteria, and include at least one risk management expert with experience in identifying, assessing and managing risk at large, complex financial institutions. This provision differs from one proposed in an earlier version of the legislation considered by the U.S. Senate, which would have required that the boards of all listed public companies, with limited exceptions, form a separate risk committee composed solely of independent directors. The risk committee provision will not affect the vast majority of public companies, many of which currently address risk through the full board or another board committee. Although the SEC adopted rules in December 2009 requiring companies to disclose the extent of the board's role in the company's risk oversight,[9] most companies did not form risk oversight committees but instead delegate responsibility for risk oversight among the board committees and the full board. The Fed is required to issue final rules implementing the risk committee requirements within 12 months of the transfer date, to take effect no later than 15 months after the transfer date. **Sec. 165(h) (p. 56).**

14. Stress Tests

Fed Tests. The Fed (in coordination with the appropriate primary financial regulatory agencies) is required to conduct annual stress tests of Title I Companies to determine whether such companies have the capital necessary to absorb losses as a result of adverse economic conditions. **Sec. 165(i)(1)(A) (pp. 56-57).** The Fed is to provide at least 3 different sets of test conditions (baseline, adverse, and severely adverse) and may require the tests be conducted for all BHCs and NBFCs in addition to Title I Companies. The Fed must also require Title I companies to update their rapid resolution plans based on the results of stress tests. **Sec. 165(i)(1)(B) (p. 57)**.

Company Tests. Title I Companies must conduct their own semi-annual stress tests and all other financial companies with consolidated assets of more than $10 billion that are regulated by a primary Federal financial regulatory agency must conduct annual stress tests. These companies must submit a report to the Fed and to the primary federal regulatory agency on the

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[9] See the SEC's Release No. 33-9089, issued December 16, 2009, available here.

tests containing information "as the primary financial regulatory agency shall require." **Sec. 165(i)(2)(A) and (B) (p. 57)**. Each federal primary financial regulatory agency—in coordination with the Fed and the FIO—must issue comparable regulations implementing the company stress test requirement, including defining "stress test," establishing methodologies for conducting tests with 3 sets of conditions, and establishing the form and content of the required reports. **Sec. 165(i)(2)(C) (pp. 57-58)**.

15. Leverage Limitation

Title I Companies are required to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that the company poses a grave threat to financial stability and the imposition of such requirement is necessary to mitigate risk. The Fed is required to promulgate implementing regulations and timelines for compliance. **Sec. 165(j) (p. 58).**

16. Inclusion of Off-Balance-Sheet Activities in Computing Capital Requirements

The computation of capital for the purposes of meeting capital requirements for any Title I Company must take into account any off-balance-sheet activities. However, the Fed has discretion to exempt companies or any transaction or transactions from this requirement. For these purposes, "off-balance-sheet activities" is defined as "an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event". **Sec. 165(k) (p. 58)**. The definition then goes on to list the following non exclusive list of "future events":

i. Direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit;

ii. Irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities;

iii. Risk participations in bankers' acceptances;

iv. Sale and repurchase agreements;

v. Asset sales with recourse against the seller;

vi. Interest rate swaps;

vii. Credit swaps;

viii. Commodities contracts;

ix. Forward contracts;

x. Securities contracts; and

xi. Such other activities or transactions as the Fed may, by rule,

define. **Sec. 165(k) (pp. 58-59)**.

17. Limitations on Acquisitions

A Title I Company is not permitted to acquire ownership or control of any company with assets of $10 billion or more that is engaged in financial activities (under Section 4(k) of the BHC Act) without providing prior notice to the Fed. **Sec. 163 (pp. 48-49)**. Specifically, Supervised NBFCs are treated as BHCs for purposes of Section 4 of the BHC Act. **Sec. 163(a) (p. 48)**. In addition, a Title I Company may not acquire control of any voting shares of a company engaged in Section 4(k) financial activities with assets of $10 billion or more without providing advance written notice to the Fed. **Sec. 163(b)(1) (p. 49)**. Note, however, that this notice requirement does not apply to acquisitions under Section 4(c) or Section 4(k)(4)(E) of the BHC Act. **Sec. 163(b)(2) (p. 49)**. The Fed is to consider the extent to which the proposed acquisition would result in greater concentrated risks to global or U.S. financial stability. **Sec. 163(b)(4) (p. 49)**.

18. Remedial Action

The Fed, in consultation with the Fed and FDIC, must prescribe regulations providing for the early remediation of financial distress in a Title I Company but provides specifically that nothing in the provision can authorize financial assistance from the Federal Government. **Sec. 166(a) (p. 59)**. The purposes of these regulations is to establish "a series of specific remedial actions to be taken by a [Title I Company] that is experiencing increasing financial distress." **Sec. 166(b) (p. 59)**. Specifically, the regulations need to define measures of the financial condition of the company including regulatory capital, liquidity measures, and forward-looking indicators and establish requirements that increase in stringency as financial condition deteriorates. **Sec. 166(c) (p. 59)**.

The Council and the Fed can take aggressive remedial action against a company that poses a meaningful threat to U.S. financial stability. If the Fed determine that a Title I Company poses such a "grave thereat" to the financial stability of the United States, the Fed upon a two-thirds vote of the Council <u>must</u> take at least one of the following five actions:

i. limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company;

ii. restrict the ability of the company to offer a financial product or products;

iii. require the company to terminate one or more activities;

iv. impose conditions on the manner in which the company conducts 1 or more activities; or

v. if the Fed determines that the none of these four actions described are inadequate to mitigate a threat to the financial stability of the United States in its recommendation, require the company to sell or otherwise transfer assets or off-balance-sheet items to

unaffiliated entities. **Sec. 121(a) (pp. 36-37)**.

Companies subject to this remedial action have the opportunity to appeal the decision of the Fed and Council through notice and hearing. The Fed and Council must give such a company written notice of the action being considered, including the basis for it. The company then has 30 days from the receipt of this notice to request a written or oral hearing, which the Fed must schedule for a date within 30 days of its receipt of a timely request. Within 60 days of the hearing date (or within 60 days of the provision of notice if no hearing was scheduled) the Fed must notify the company of its final decision. In making its decision the Fed and Council are to take into consideration the factors considered when determining whether to subject a NBFC to Fed supervision. In addition, if the Fed is considering applying this provision to foreign companies, then it must give due regard to the principals of national treatment and equality of competitive opportunity and also take into account the extent to which the company is subject to regulation in its home country. **Sec. 121(b)-(d) (p. 37)**.

F. Minimum Leverage and Risk-Based Capital Requirements

Title I includes multiple provisions addressing capital requirements, as does Title VI. The Title I capital requirement provisions are discussed below.

1. Leverage Limits and Risk-Based Capital Requirements

Under the prudential standards requirements, the Fed is required (in consultation with the Council) to adopt capital rules for Title I Companies, including leverage limits and risk-based capital requirements. These requirements must be "more stringent" than those applied to other NBFCs and BHCs and "increase in stringency" based on the extent of the applicability of the considerations used for designation of Supervised NBFCs. **Sec. 115(a)(1) (p. 29)**.

2. Debt to Equity Limits

As discussed under "prudential standards," a Title I Company will be required to maintain a debt to equity ratio of no more than 15 to 1 upon a determination by the Council that the company poses a grave threat to financial stability and the imposition of this requirement is needed to mitigate risk. **Sec. 165(j) (p. 58).**

3. Contingent Capital Requirements

Also as discussed under "prudential standards," subsequent to a study conducted by the Council, the Fed may adopt contingent capital requirements for Title I Companies, designed to "maintain a minimum amount of long-term hybrid debt that is convertible to equity in times of financial stress." **Sec. 165(c)(1) (p. 52)**.

4. Leverage and Risk-Based Capital Requirements

Under the "Collins Amendment," set out in Section 171, the appropriate Federal banking agencies must establish minimum leverage capital and risk-based capital requirements for insured depository institutions, BHCs, SLHCs and Supervised NBFCs. For this purpose "leverage capital" refers to the ratio of tier 1 capital to total average assets. These capital

requirements may "not be less than" the minimum generally applicable capital standards for banks as of the date of enactment, applying the standards and measures under the prompt corrective action regulations—i.e., only instruments that may be included in calculating tier 1 capital adequacy for banks may be used in holding company capital adequacy calculations. For example, trust preferred debt securities would be excluded from tier 1 capital. **Sec. 171 (p. 62)**. Consider the following elements of the Collins Amendment:

i. The Collins Amendment requirements are to be applied without regard to total consolidated asset size or foreign financial exposure.

ii. Bank minimum standards as of the date of enactment are a floor for the requirements as applied to insured depository institutions, deposit institution holding companies, and Supervised NBFCs.

iii. This section is immediately effective for instruments issued after May 19, 2010 by depository institution holding companies and Supervised NBFCs. For debt or equity instruments issued before May 19, 2010, any regulatory capital deductions required by the section are to be phased in incrementally over three years beginning January 1, 2013.

iv. For "depository institution holding companies not previously supervised" by the Fed —savings and loan holding companies ("SLHCs")—the provision does not take effect until 5 years after enactment, except for the provisions that call for the three-year phase in of previously issued debt and equity instruments.

v. A holding company that had less than $15 billion in consolidated assets as of December 31, 2009 and any mutual holding company as of May 19, 2010 would not be required to implement the capital deductions applied to large companies.

vi. The Collins Amendment provisions do not apply to any instruments issued to the U.S. government under the Emergency Economic Stabilization Act of 2008, or to any Federal home loan bank, or any "small bank holding company" (defined as one with *pro forma* consolidated assets of less than $150 million). **Sec. 171 (pp. 62-65)**.

5. Studies and Reports on Holding Company Capital Requirements

a. Studies

Study of Hybrid Capital Instruments. The Comptroller General, in consultation with the Fed, the Comptroller of the Currency (the "Comptroller" or "OCC"), and the FDIC, are required to conduct a study of the use of hybrid capital instruments as a component of tier 1 capital for banking institutions and BHCS. The study must consider current use, difference between the components of capital permitted for insured depository institutions and for companies that

control depositories, the benefits and risks of allowing such instruments to comply with tier 1 capital requirements, the economic impact of a prohibition, a review of the consequences of disqualifying trust preferred instruments, the international competitive implications of such a move, the impact on the cost and availability of credit in the United States, the availability of capital for financial institutions with less than $10 billion in total assets, and any other relevant factors. **Sec. 174(a) (pp. 67-68)**. A report on this study must be submitted to Congress within 18 months of enactment. **Sec. 174(c) (p. 68)**.

Study of Foreign Bank IHC Capital Requirements. The Comptroller General, in consultation with the Secretary, the Fed, the Comptroller, and the FDIC are to conduct a study of capital applicable to U.S. IHCs of foreign banks that are BHCs and SLHCs. **Sec. 174(a) (p. 68)**.

b. Well Capitalized/Well Managed Requirement

Title VI includes an additional provision that enhances the Gramm-Leach-Bliley requirements for BHCs and SLHCs engaged in "financial activities" by imposing a "well capitalized/well managed" requirement on such BHCs and SLHCs. **Sec. 606 (p. 236)**. Currently, only banks in a financial holding company are subject to the "well capitalized/well managed" requirement. "Financial activities" include merchant banking, investment banking, insurance and other activities "closely related to banking." "Well capitalized" for banks means 10% total risk based capital ratio and 6% tier 1 risk based capital ratio under Regulation Y.

G. Countercyclical Capital Requirement

Title VI grants the Fed express authority to adopt capital rules for all BHCs and SLHCs. **Sec. 616 (p. 245)**. Title VI also requires that the Fed seek to make all capital requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction. **Sec. 616 (p. 245)**.

H. Intermediate Holding Companies and Activities of a Supervised NBFC

1. Role of the Fed in Establishing Intermediate Holding Companies

If a Supervised NBFC conducts activities that are not financial in nature (under Section 4(k) of the BHC Act), the Fed may require that the company establish an IHC in which it conducts "all or a portion" of its financial activities, not including internal financial activities. **Sec. 167(b)(1) (p. 59)**. The Fed must require a Supervised NBFC to establish an IHC if it deems this is necessary for the Fed to appropriately supervise the company's financial activities, or to ensure that supervision by the Fed does not extend to the activities of such company that are not financial in nature. **Sec. 167(b)(1)(B) (p. 59)**. Under these provisions, even though a Supervised NBFC would be at least 85% financial, it could be required to transfer some or all of its financial activities, other than "internal financial activities," to an IHC subsidiary.

2. Exception for Internal Financial Activities

A Supervised NPFC forming an IHC can continue to perform "internal" financial activities outside of the IHC structure, and can continue to perform these activities for some

external parties. Activities that are required to be conducted in an IHC under this provision (because they are determined to be financial in nature or incidental thereto under Section 4(k) of the BHC Act) are not "internal financial activities," which include "internal treasury, investment, and employee benefit functions." **Sec. 167(b)(2) (p. 59)**. In addition, any "internal financial activity" that the company or an affiliate engaged in for itself and a non-affiliate during the year prior to enactment, the company (or affiliate that is not an IHC or a subsidiary if an IHC) can continue to engage in (outside of the IHC) as long as at least two-thirds of the assets or two-thirds of the revenues generated by the activity are attributable to the company or an affiliate (subject to the Fed's ability to review and determine that the activity presents an undue risk to the company or U.S. financial stability). **Sec. 167(b)(2) (p. 59)**.

3. Regulations

Note that the Fed must issue regulations establishing criteria for determining whether a Supervised NBFC must establish an IHC.

4. Affiliate Transaction Rules

The Fed may issue regulations to establish restrictions or limitations on transactions between an IHC and a Supervised NBFC as needed to prevent unsafe and unsound practices between a parent company and its affiliates. **Sec. 167(c) (p. 61)**. However, note that the Fed may not adopt affiliate transaction rules for IHCs that would "restrict or limit any transaction in connection with the *bona fide* acquisition or lease by an unaffiliated person of assets, goods, or services." **Sec. 167(c) (p. 61)**. These regulations—like all regulations to be issued by the Fed under Subtitles A and C of Title I—must be issued within 18 months of the effective date of the Act. **Sec. 168 (p. 61)**.

5. Source of Strength

A company that directly or indirectly controls such an IHC must serve as a source of strength to its subsidiary IHC. **Sec. 167(b)(4) (p. 60)**.

6. Reports

The parent of an IHC may be required to file reports, as the Fed determines, to allow assessment of compliance and ability to serve as a source of strength. The Act also states expressly that the parent company will be subject to the enforcement provisions of Section 8 of the FDI Act as if it were a BHC. **Sec. 167(b)(5) (p. 60)**.

7. Parallel to Title VI IHC Provisions

Note that the Title I IHC provisions closely parallel IHC provisions for certain grandfathered SLHCs under Title VI, which deals with the regulation of SLHCs and depository institutions. A grandfathered SLHC might also be a Supervised NBFC and thus subject to both sets of IHC provisions. House Financial Services Chairman Frank addressed this possibility in a floor colloquy at the time of final passage of this legislation by the House and stated that these provisions are intended to be applied "in harmony" so that affected firms will not be subject to inconsistent requirements.

I. Examination and Enforcement Actions for Insurance and Orderly Liquidation Purposes

Title I amends Section 10(b)(3) of the FDI Act to provide that, with regard to a Title I Company, whenever the FDIC determines that a special examination of any depository institution subsidiary for insurance purposes or of a Title I Company itself for the purpose of implementing its authority to provide for an orderly liquidation under Title II, the Fed can examine the company unless the company is "in generally sound condition." **Sec. 172(a) (p. 65)**. The Title also provides that before conducting such a special examination, the FDIC must review any available and acceptable resolution plan that the company has submitted and must coordinate with the Fed. **Sec. 172(a) (pp. 65-66)**.

J. Access to United States Financial Markets by Foreign Institutions

1. Foreign Banks

Title I amends Section 7(d)(3) of the International Banking Act to provide that a foreign bank that presents a risk to U.S. financial stability may only establish bank offices in the United States if the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, "an appropriate system of financial regulation for the financial system of such home country to mitigate such risk." **Sec. 173(a) (p. 66)**. Moreover, foreign bank offices in the United States may be terminated if a foreign bank that represents risk to U.S. financial stability if its home country has not adopted or made progress in adopting such an appropriate system of financial regulation. **Sec. 173(b) (p. 67)**.

2. Foreign Brokers or Dealers

Title I amends Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act") to provide that the SEC, in determining whether to permit a foreign person to register in the United States as a broker dealer (or succeed to the registration of a U.S. broker or dealer), may consider whether, for a person that presents a risk to U.S. financial stability, the home country of the person has adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk. The SEC may terminate the registration of such a person if such progress in the home country has not been made. **Sec. 173(c) (p. 67)**.

K. Study on the Effects of Size and Complexity of Financial Institutions on Capital Market Efficiency and Economic Growth

The Chairperson of the Council is required to carry out a study and issue a report to Congress within 180 days of enactment and every 5 years thereafter of the economic impact of possible financial services regulatory limitations intended to reduce systemic risk. The study must estimate the benefits and costs on the efficiency of capital markets, the financial sector, and national economic growth of:

i. Limits on the maximum size of banks, BHCs, and other large financial institutions;

ii. Limits on the organizational complexity and diversification of large financial institutions;

iii. Requirements for operational separation between business units of large financial institutions in order to expedite resolution in case of failure;

iv. Limits on risk transfer between business units of large financial institutions;

v. Requirements to carry contingent capital or similar mechanisms;

vi. Limits on commingling of commercial and financial activities by large financial institutions;

vii. Segregation requirements between traditional financial activities and trading or other high-risk operations in large financial institutions; and

viii. Other limitations on the activities or structure of large financial institutions that may be useful to limit systemic risk. **Sec. 123 (p. 38)**.

L. Office of Financial Research

1. Functions of the Office

Subtitle B of Title I relates to the formation and function of the Office. The purpose of the Office, which has rulemaking authority to support its functions, is to support the Council in fulfilling its duties, including by:

i. Collecting data on behalf of the Council, and providing such data to the Council and member agencies;

ii. Standardizing the types and formats of data reported and collected;

iii. Performing applied research and essential long-term research;

iv. Developing tools for risk measurement and monitoring;

v. Performing other related services;

vi. Making the results of the activities of the Office available to financial regulatory agencies; and

vii. Assisting such member agencies in determining the types and formats of data authorized by this Act to be collected by such member agencies. **Sec. 153(a) (p. 41)**.

2. Director of the Office

The provisions call for the Director of the Office to be appointed by the President with the advice and consent of the Senate and serve for a term of 6 years. **Sec. 152(b) (p. 39)**. The Director and other Office employees with access to data maintained in the Data Center are to be prohibited from working or consulting for a financial company for one year following having had access to such data. **Sec. 152(g) (p. 40)**.

3. Data Center

The Data Center is one of the two major structures within the Office. Its function is to collect, validate and maintain data obtained from member agencies, commercial data providers, and public sources. The Office has authority (which must be determined by the Council or by the Director in consultation with the Council) to require the submission of reports from any financial company for the purpose of assessing the extent to which a financial activity or financial market in which the company participates poses a threat to U.S. financial stability. **Sec. 154(b) (p. 43)**. Note that for these purposes, the term "financial company" has the same meaning as in Title II and includes an insured depository institution and an insurance company. **Sec. 151(1) (p. 39)**. The Office is to promulgate regulations regarding the type and scope of data to be collected by the Data Center. **Sec. 154(b)(1)(C) (p. 43)**. While the Data Center is to publish a financial company reference database, a financial instrument reference database and the standards for reporting data to the Office, it is also required not to publish confidential data and the Director is to ensure that any data collected is secure and protected from unauthorized disclosure. **Sec. 154(b)(2) and (3) (p. 43).**

4. Research and Analysis Center

The Research and Analysis Center—the other major structure within the Office—is required to develop and maintain independent analytical capabilities and computing resources needed to do the following:

i. Develop and maintain metrics and reporting systems for risks to the financial stability of the United States;

ii. Monitor, investigate, and report on changes in system-wide risk levels and patterns to the Council and Congress;

iii. Conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets;

iv. Evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies;

v. Maintain expertise in such areas as may be necessary to support specific requests for advice and assistance from financial regulators;

vi. Investigate disruptions and failures in the financial markets, report

findings, and make recommendations to the Council based on those findings;

vii. Conduct studies and provide advice on the impact policies related to systemic risk; and

viii. Promote best practices for financial risk management. **Sec. 154(c) (p. 44)**.

5. Reporting Responsibilities

The Office is to submit a report to Congress assessing the state of the U.S. financial system (including any threats to financial stability and the status of the Office's efforts to meet its mission) within 2 years of enactment and within 120 days of the end of each succeeding fiscal year. **Sec. 154(d) (p. 44)**.

6. Paying for the Office

Title I Companies will be charged an assessment that will cover the total expenses of operating the Office. The assessment base and rates will be established by the Secretary with the approval of the Council and will take into account differences among the assessed companies. **Sec. 155(d) (p. 45)**. These assessments will begin two years after enactment, with funding during the first two years provided by the Fed. **Sec. 155(c) (p. 45)**.