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# **The Dodd-Frank Wall Street Reform and Consumer Protection Act: Game Changer?**

## **Expanded Regulation of Banks**

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**November 17, 2010**

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# Impacts on Bank and Thrift Holding Companies

# Impacts on Bank Holding Companies

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- New Requirements (To Be Discussed)
  - Capital
  - 10% nationwide liability cap; other M&A rules
- Examination of Non-Depository Subsidiaries
  - Repeal of limits on “Functionally Regulated” Subs
  - Requirement to examine certain Non-Functionally Regulated Subs; Back-up Authority
- Risk Committees
  - Required of all publicly traded BHCs with consolidated assets  $\geq$  \$10 billion

# Impacts on Bank Holding Companies

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- Stress Tests
  - Annual stress tests for all BHCs with consolidated assets > \$10 billion
  - Semi-annual for BHCs with consolidated assets ≥ \$50 billion
- FDIC back-up examination and enforcement authority
- BHC-specific restrictions/requirements applicable to BHCs designated as systemically significant (SSFCs) .

# Impacts on Thrift Holding Companies: Demise of the OTS

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- Transfer Date – 7/21/11 (extendable to 1/21/12)
- OTS abolished
  - 90 days after the Transfer Date
  - OCC to have new Deputy Comptroller responsible for supervision and regulation of thrifts
- Transfer of OTS powers and duties
  - FRB. Supervision and rulemaking over thrift holding companies
  - OCC. Supervision over federal thrifts; rulemaking (with certain exceptions) over all thrifts
  - FDIC. Supervision over state thrifts

# Impacts on Thrift Holding Companies

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- New Capital Requirements
- FRB supervision and examination
  - HOLA still applies
  - Study regarding elimination of BHCA exception
  - With FRB as regulator, is BHCA de facto supervisory standard?
- “Source of Strength”
- Stress tests

# M&A Limitations

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- FRB approval of certain non-bank financial companies
  - Applies if assets to be acquired > \$10B
  - Exemptions
- Overall entity must not exceed 10% of aggregate liabilities of all financial companies

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# Volcker Rule



# The Volcker Rule – In Brief

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“Unless otherwise provided in this section, a banking entity shall not –

(A) engage in proprietary trading; or

(B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.”

# Volcker Rule

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- Scope – “Banking Entities”
  - Virtually all insured banks or thrifts
  - The companies that control them
  - Their affiliates and subsidiaries
  - Foreign banks with U.S. banking presence
- Timing
  - Effective Date: Earlier of 12 months after issuance of final rules, and 2 years after date of enactment
  - Transition Period: Bank entities must comply within 2 years after effective date (2014)
  - Extensions: Available at FRB discretion

# Volcker Rule

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- Proprietary Trading:
  - “engaging as principal for the trading account” of the banking entity to purchase, sell, or otherwise acquire or dispose of any security, derivative, future, option, or other financial instrument, as determined by the agencies’ rules
- Trading Account:
  - an account used “principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements),” and any other such accounts as determined by the agencies’ rules

# Volcker Rule

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- Private Equity and Hedge Funds – Scope:
  - Any issuer that would be an investment company as defined under the Investment Company Act of 1940 but for the exemptions provided by under Sections 3(c)(1) or 3(c)(7) of that Act.
  - And “similar” funds as may be determined by the agencies by regulation.

# Volcker Rule

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- Private Equity and Hedge Funds – Prohibitions:
  - No investing: acquiring any “equity, partnership, or other ownership interest in” a private equity or hedge fund
  - No sponsoring:
    - serving as a general partner, managing member, or trustee of a fund;
    - selecting or controlling (or having employees, officers, directors or agents who constitute) a majority of the directors, trustees, or management of the fund; or
    - sharing the same name or a variation of the same name with a fund.

# Volcker Rule

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- Private Equity and Hedge Funds – Affiliate transaction rules for sponsored and advised/managed funds
  - No 23A “covered transactions” (e.g. loans, purchases of assets or securities; prime brokerage exception)
  - Other transactions on market terms (what would be offered to an unaffiliated fund)

# Volcker Rule

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## Permitted Activities:

- U.S., agency, GSE, state/municipal securities
- “On behalf of customers”
- Underwriting and market making
- Risk-mitigating hedging
- Foreign banking activities “solely outside the U.S.”
- Regulated insurance company – “for the general account”
- SBICs and public welfare investments (12 U.S.C. 24)
- Other activities agencies determine promote safety and soundness

# Volcker Rule

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## Permitted Activities:

- Fiduciary and De Minimis for Private Equity/Hedge Funds
  - 3% ownership of a fund
  - Aggregate 3% of entity's tier 1 capital
  - Other restrictions



# Volcker Rule

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Limitations on Permitted Activities – They may not:

- (i) involve a material conflict of interest with clients, customers, or counterparties;
- (ii) result in a material exposure to high-risk assets or trading strategies;
- (iii) pose a threat to the safety and soundness of the banking entity or to U.S. financial stability.

# Post-Enactment Regulation and the Volcker Rule

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- **October 1:** FSOC seeks public input on study concerning implementation of Volcker Rule
- Study seeks comment on Volcker Rule and
  - bank safety and soundness
  - institutional risk mitigation
  - limitation of capital transfers between regulated and unregulated entities
  - conflicts of interest between banks and nonbanks
  - insurance industry and financial stability
  - divestiture of illiquid assets by financial institutions after implementation of Volcker Rule.
- Comment period closed November 5

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David Luigs is a counsel in the firm's Banking Group and Financial Institutions Group. Mr. Luigs is based in the Washington, D.C., office and focuses his practice on banking, securities, and mortgage-related matters. He advises domestic and international banks, broker-dealers, mortgage companies, and other financial institutions on a wide range of regulatory, enforcement, and transactional issues. He practices before and counsels clients on compliance with the regulations and guidance of the federal and state banking and securities regulatory agencies. Mr. Luigs also advises clients regarding legislative developments and has assisted clients to develop legislative strategies, policy white papers and draft legislation.

Mr. Luigs works regularly with financial institutions in the context of mergers, acquisitions, and noncontrolling investments, and related regulatory applications. He has represented clients as both transactional and regulatory counsel in connection with the sale or acquisition of various financial institutions, including state and national banks, thrifts, and non-bank financial firms, including lending and servicing companies.

Mr. Luigs assists financial institutions in all aspects of their relationships with federal and state regulators, including charter, license, and other applications; requests for interpretive relief; responses to examination issues; and preparation of comment letters, analyses, and strategies for agency rulemakings. He counsels clients on the nature and extent of permissible powers, and he has assisted in obtaining favorable interpretive rulings from regulators expanding the scope of institutions' powers. Mr. Luigs has significant experience regarding issues at the intersection of federal banking and securities laws.

Mr. Luigs maintains an active enforcement practice and has defended institutions, boards of directors, and individual officers and directors before the federal banking agencies, the SEC and other federal and state enforcement agencies. He has represented clients in inquiries brought by Attorneys General of numerous states, including New York. He has conducted internal investigations on behalf of institutions, audit committees, and special committees of boards of directors, including 10A investigations.

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