



The Dodd-Frank Wall Street Reform and Consumer Protection Act: Titles III and VI, Regulation of Depository Institutions and Depository Institution Holding Companies

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Summary

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, P.L. 111-203, has as its main purpose financial regulatory reform. Titles III and VI effectuate changes in the regulatory structure governing depository institutions and their holding companies and, thus, constitute a substantial component of the reform effort. Under Title III, there will no longer be a single regulator of federal and state-chartered savings associations, also known as thrifts or savings and loan associations. Title III abolishes the Office of the Thrift Supervision (OTS) and contains extensive provisions respecting the rights of affected employees as well as other administrative matters. It allocates the OTS functions among three existing regulators: the Comptroller of the Currency (OCC) will regulate federally chartered thrifts; the Federal Deposit Insurance Corporation (FDIC), state-chartered thrifts; and the Board of Governors of the Federal Reserve System (FRB), savings and loan holding companies. Title III also makes certain changes to deposit insurance: it makes permanent the increase of deposit insurance coverage to \$250,000, and makes that increase retroactive to January 1, 2008. It extends full insurance coverage of non-interest bearing checking accounts for two additional years and authorizes a similar program for credit unions. Included in Title III is also a requirement that the Department of the Treasury and each federal financial regulatory agency establish an office of Minority and Women Inclusion.

Title VI addresses some perceived inadequacies with respect to prudential regulation of depository institutions and their holding companies, including the existence of certain exceptions to the Bank Holding Company Act's (BHC Act's) general prohibition on affiliation of banking institutions and commercial or manufacturing concerns; investment in hedge funds or private equity funds and proprietary trading by banking institutions; gaps in the authority of the FRB to oversee all of the subsidiaries of bank holding companies; the need for greater coordination among the regulators with respect to enforcement actions, charter conversions, and mergers and acquisitions; and elimination of some of the differences affecting the regulation of thrifts and banks, state-chartered and federally chartered institutions, and bank and thrift holding companies.

The full implications of Titles III and VI will not be apparent until the agencies promulgate the many implementing regulations required before many of the provisions go into effect. Generally, the legislation specifies a time period for when a particular rulemaking is to be completed; in some cases, studies are required before the rulemaking may occur.

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Background and Overview

Titles III and VI of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, P.L. 111-203, address certain issues that many Members of Congress, including the major drafters of the legislation, the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs, perceived as impediments to effective regulation of the banking industry and possible contributing factors to certain aspects of the financial crisis of 2008. The version of Title III reported by the Senate Committee on Banking, Housing, and Urban Affairs, on which the final version is based, sought “to increase the accountability of the banking regulators by establishing clearer lines of responsibility and to reduce the regulatory arbitrage in the financial regulatory system whereby financial companies ‘shop’ for the most lenient regulators and regulatory framework.”¹ The final version takes a step in that direction by abolishing one of the regulators, the Office of Thrift Supervision (OTS), the agency which had supervisory authority over Washington Mutual and Indy Mac Bank, the failures of which represented large losses to the Deposit Insurance Fund. The act distributes the OTS functions, regulating savings associations (thrifts or savings and loans) and savings and loan holding companies. Under Title X of the bill, the Consumer Financial Protection Bureau (CFPB) will assume much of the OTS responsibility for overseeing compliance by savings and loan associations with federal consumer protection laws. Title III allocates prudential supervision among three federal regulators. The Office of the Comptroller of the Currency (OCC) will now regulate federally chartered thrifts as well as national banks; the Federal Deposit Insurance Corporation (FDIC) will now regulate state-chartered thrifts as well as state-chartered banks which are not members of the Federal Reserve System (FRS); and the Board of Governors of the Federal Reserve System (FRB) will now regulate both bank holding companies (including financial holding companies) and thrift or savings and loan holding companies, as well as state-chartered banks which are members of the Federal Reserve System (FRS). Other provisions of Title III provide for reallocation of OTS personnel and property among those agencies, with various safeguards respecting employee rights and status.

Many of the provisions of Titles III and VI appear to be designed to correct perceived inadequacies in terms of the prudential regulation of banks, savings associations, bank holding companies, and savings and loan holding companies or discrepancies between the regulation of banks and savings associations. For example, there are provisions preventing depository institutions under supervisory or enforcement orders from changing their charters without full consent by the existing chartering authority and a plan for meeting the requirements of the enforcement order. There are numerous provisions requiring greater coordination among regulators and provisions enhancing the authority of FRB to oversee all of the components of holding companies. There are also provisions providing backup examination and enforcement authority in case the FRB’s efforts fail to meet the standards imposed under the statute. There are various provisions designed to minimize regulatory differences applicable to different types of banking institutions and to address what have appeared to be loopholes permitting certain companies to own or control a depository institution without having to submit to consolidated regulation by the FRB under the Bank Holding Company Act (BHC Act).²

¹ S.Rept. 111-176, 111th Cong., 2d Sess. 23 (2010).

² 12 U.S.C. 1841 *et seq.*

Miscellaneous matters addressed in Title III include changing the basis of deposit insurance assessments imposed on banks; permanently increasing deposit insurance coverage to \$250,000; applying that increase retroactively to January 1, 2008; and establishing offices of Minority and Women Inclusion in the Department of the Treasury and in the federal financial regulatory agencies.

Title VI contains a number of provisions designed to tighten regulation of banking activities possibly threatening the safety and soundness of depository institutions and their holding companies. There are provisions tightening the controls on transactions with affiliates, derivative and swaps operations, and lending limits. There are also restrictions on banking companies making investments in hedge funds or private equity funds or engaging in proprietary trading, patterned on a proposal by a former FRB Chairman and current Chairman of the President's Economic Recovery Advisory Board.³

Title III: Enhancing Financial Institution Safety and Soundness Act of 2010

Overview of Title III

Title III consists of three subtitles. Subtitle A transfers the powers and duties of the OTS and establishes a transfer date for the transfers to become effective. Subtitle B provides for the transition to the new regulatory structure. Subtitle C contains several provisions affecting the FDIC and deposit insurance. Subtitle D includes various provisions including establishment of the Office of Minority and Women Inclusion within federal financial regulatory agencies and the Department of the Treasury, branching by depository institutions; and extension of temporary deposit insurance coverage of transaction accounts. What follows are summaries of sections of Title III relating to substantive changes in the regulation of depository institutions and their holding companies.

Transfer of OTS Functions to the OCC, FDIC, and FRB

Distribution of OTS Functions

Section 311 requires that OTS functions are to be distributed to the OCC, FDIC, and FRB one year after enactment, subject to a six-month extension.

Section 312 transfers the authority of OTS and the Director of OTS as follows:

- To the FRB, the authority to supervise, issue rules, and take enforcement actions respecting any savings and loan holding company and any of its subsidiaries, other than a depository institution;

³ For further information see, CRS Report R41298, *The "Volcker Rule": Proposals to Limit "Speculative" Proprietary Trading by Banks*, by David H. Carpenter and M. Maureen Murphy.

- To the OCC, the authority to supervise, issue rules, and take enforcement actions respecting any federally chartered savings association or thrift; and,
- To the FDIC, the authority to supervise, issue rules, and take enforcement actions respecting any state-chartered savings association or thrift.

Section 313 abolishes the OTS and the position of Director of the OTS effective 90 days after the transfer.

Section 314 charges OCC, in addition to its other functions, with “assuring ... fair access to financial services and fair treatment of customers by the institutions and other persons subject to its jurisdiction, and requires the Comptroller of the Currency to designate a Deputy Comptroller for supervising and examining federal savings associations.

Transition from OTS to New Regulators

Sections 315, 316, 317, 318, and 319 are essentially technical in nature. For example, they include provisions that preserve OTS regulations, orders, agreements, regulations, and law suits and establish a method for the agencies to which OTS functions are transferred to effectuate the transition. There are provisions respecting funding, contracting and leasing authority, and setting forth a procedure for the agencies to which OTS functions are transferred to assume responsibility.

Sections 321, 322, 323, 324, 325, and 326 address various matters that arise during the transition period by outlining the type of consultation and cooperation to take place among the transferee agencies and the OTS with respect to payment of expenses; transfer of personnel; property and administrative services; and any other necessary actions for orderly implementation. OTS employees are to be transferred to the OCC and FDIC (and the Consumer Financial Protection Bureau) based on the functions they perform. Various provisions make allowances for employee retention rights with respect to salary and benefits, including retirement benefits. There are also provisions for transferring OTS property, contracts, and funds and for the OTS Director to wind up the affairs of the agency after the transfers have been accomplished.

Report Outlining Transition Implementation Plan

Section 327 requires the agencies jointly to submit, within 60 days of enactment, a plan for implementing Title III to the Senate Banking Committee and the House Financial Services Committee as well as to the Inspectors General (IGs) of Treasury, FDIC, OCC, OTS, and FRB. Within 60 days of receiving the plan, the IGs are to submit a written report on the proposed plan addressing various factors relating to the plan’s fair, efficient, and orderly implementation of the requirements of the legislation. The Treasury, FDIC, and FRB IGs are to submit joint reports every six months on implementation of the plan.

Deposit Insurance Fund and Enhanced FDIC Authority

Assessments Based on Assets Rather Than Insured Deposits

Section 331 alters the basis on which assessments on depository institutions for deposit insurance are calculated. No longer will assessments be based on the amount of insured deposits; rather

assessments generally are to be based on “the average consolidated total assets of the insured depository institution ... minus ... the sum of—the average tangible equity of the insured depository institution ...” There is authority for the FDIC to vary this for custodial banks (banks with a percentage of revenues generated by assets under custody) and banker’s banks (banks providing banking services to other banks).

Elimination of Procyclical Assessments

Section 332 eliminates a requirement that the FDIC refund or credit to the next assessment any overpayments of assessments and authorizes it to suspend or limit the payment of dividends from excess reserves in the deposit insurance fund. The section also requires the FDIC to issue regulations on refunding overpayments or limiting dividend payments.

FDIC May Require Reports Without Getting Approval of Primary Regulator

Section 333 eliminates a requirement that FDIC receive a depository institution’s primary federal regulator’s approval before requiring additional reports from an insured depository institution. All that is now necessary is consultation with the primary federal regulator.

Increase in the Minimum Reserve Ratio

Section 334 increases the minimum reserve ratio for the Deposit Insurance Fund from 1.15% to 1.35% of estimated insured deposits or the comparable percentage of the assessment base. It requires the FDIC to take the steps necessary for the reserve ratio to reach that goal by September 30, 2020. It also requires the FDIC to “offset the effect [of this requirement] ... on insured depository institutions with total consolidated assets of less than” \$10 billion.

Permanent Deposit Insurance Increase to \$250,000; Applied Retroactively for Depositors of Institutions Which Failed in 2008

Section 335 effectuates a permanent increase in deposit insurance and share insurance for insured depository institutions and insured credit unions to \$250,000, and applies this increase retroactively to the depositors of any institution for which the FDIC was appointed receiver after January 1, 2008. This will cover depositors in such institutions as IndyMac Bank, F.S.B., Pasadena, California, which was closed by the OTS, with the FDIC named as Conservator, on July 11, 2008.⁴

⁴ FDIC, Failed Bank Information, Failed Bank Information for IndyMac Bank, F.S.B., and IndyMac Federal Bank, F.S.B., Pasadena, CA, <http://www.fdic.gov/bank/individual/failed/IndyMac.html#Introduction>.

Director of the Consumer Financial Protection Bureau, Ex-Officio Member of FDIC Board

Section 336 substitutes the Director of the Consumer Financial Protection Bureau for the OTS Director to serve with the Comptroller of the Currency as ex-officio members of the FDIC Board of Directors along with three presidentially appointed members. It provides for an acting official to serve in case of a vacancy or disability of an ex-officio board member.

Branching Authority of Savings Associations Converting to Bank Status

Section 341 authorizes a savings association converting to bank status to continue to operate any branch that it was operating immediately before the conversion and to acquire any additional branches in any state in which it operated a branch immediately before becoming a bank in any location in that state if the state law would permit a bank chartered in that state to operate a branch in that location.

Office of Minority and Women Inclusion in Federal Financial Regulatory Agencies

Section 342 requires the Consumer Protection Bureau, Treasury, OCC, FDIC, FRB, each Federal Reserve bank, the Federal Housing Finance Agency, the National Credit Union Administration, and the Federal Trade Commission to establish an Office of Minority and Women Inclusion “responsible for all matters of the agency relating to diversity in management, employment, and business activities.” The Director of these offices is to be a career reserved position in the Senior Executive Service, and is to develop standards on equal employment opportunity; increased participation of minority- and women-owned businesses in agency programs; and assessment of the diversity policies of the regulated entities. There is also a provision authorizing the Director to recommend termination of contractors “who have failed to include minority and women in their workforce.” Section 342 requires annual reports from these offices and imposes upon the agencies obligations to make efforts to seek workforce diversity by recruiting practices and partnering with organization devoted to these goals, including inner-city high schools.

Deposit Insurance for Non-Interest Bearing Checking Accounts

Section 343 requires the FDIC and the NCUA to provide deposit insurance and share insurance coverage, without any cap or limit, for non-interest bearing transaction accounts. This authority sunsets January 1, 2013.

Sections 351- 378 consist of technical and conforming amendments to conform other sections of the law to changes made in Title III.

Title VI: Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

Title VI, the Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010, addresses some of the issues that have been viewed as possibly weakening the ability of banking companies to focus on their main business of financial intermediation—accepting retail deposits that earn a modest return at no risk of loss to depositors and transforming them into capital that is available for lending and, thereby, fostering economic growth and activity. Title VI includes a temporary moratorium on FDIC approval of deposit insurance for new industrial loan companies and credit card banks; authority to segregate into intermediate holding companies the commercial activities of unitary thrift holding companies which have been able to combine an insured depository with commercial activities under exceptions to the BHC Act; broader authority for the FRB to supervise holding companies; further lending limits on depository institution loans to insiders; stricter capital levels for holding companies; prohibitions on proprietary trading and investment in hedge funds by banking companies; various requirements for studies (including a study on subjecting savings association holding companies to the BHC Act); and specific provisions aimed at such particular activities or powers of banks and thrifts.

What follows is a brief summary of each of the sections of Title VI except for those which are essentially technical in nature.

Moratorium and Study on Treatment of Credit Card Banks and Industrial Loan Companies

Section 603 establishes a three-year moratorium during which the FDIC may not approve deposit insurance for any new credit card bank, industrial bank, or trust bank or any application for change in control of any existing institution of those types that has the result that a “commercial firm” acquires control of the institution, i.e., a firm which has 85% of its annual gross revenues derived from activities other than control of depository institutions and activities that are financial in nature. There are exceptions for change in control situations involving an institution which is in default or danger or default; for the merger or whole acquisition of the commercial firm; or for the acquisition of voting shares of less than 25% of the commercial firm.

This section also requires that, within eighteen months, the Government Accountability Office (GAO) must submit a study of whether it is necessary to eliminate certain exceptions to the BHC Act definition of “bank” or “bank holding company” that allow certain companies to avoid being subject to the requirement that companies owning or controlling banks be subject to FRB regulation under the BHC Act. In this study, GAO is to identify types and numbers of institutions, their size, geographic location, commercial affiliates, and their federal supervisor. GAO is to evaluate the adequacy of the applicable regulatory frameworks and the consequences of subjecting the institutions to the BHC Act. Among the exceptions that GAO is to study are (1) state-chartered banks owned by thrift associations and limited to taking deposits for thrift associations; (2) a bank controlled by a trust company or mutual savings bank in the same state as of December 31, 1970, provided that, subject to an exception for investments authorized for

national banks, the trust company or mutual savings bank does not acquire any interest in a company which would give it 5% of the voting shares of the company; (3) institutions which function only in a trust or fiduciary capacity, subject to certain activities restrictions; (4) credit card banks; (5) industrial loan companies; and (6) savings associations.

Reports and Examinations of Holding Companies and Regulation of Holding Company Subsidiaries

Expanded FRB Authority

Section 604 expands the FRB's authority with respect to bank holding company subsidiaries in several ways and, thereby, modifies the "Fed-lite" provisions of the Gramm-Leach Bliley Act of 1999 (GLBA).⁵ Section 604(c) removes the strict limitations on FRB authority to take direct action against functionally regulated subsidiaries⁶ of bank holding companies.⁷ Section 604(a) extends the authority of the FRB to require reports from bank holding companies and their subsidiaries to cover compliance with any applicable federal law in addition to those laws which the FRB has explicit authority to enforce. Exempted from this authority are functionally regulated subsidiaries and insured depository subsidiaries. In seeking reports from bank holding company subsidiaries, the FRB is to use existing reports and supervisory materials as much as possible. Section 604(b) expands FRB's authority to examine bank holding company subsidiaries by specifically including risks to U.S. financial stability as a focus of the examination and by authorizing it to monitor, except for functionally regulated subsidiaries and depository institution subsidiaries, how the subsidiaries are complying with any other applicable federal law (subject to the allocation of examination functions under the Consumer Financial Protection Act of 2010). Section 604(c) also adds to the definition of "functionally regulated subsidiaries" certain entities which are subject to regulation or registration with the Commodities Futures Trading Commission.⁸ Sections 604(g) and (h) provide parallel authority for the FRB to require reports and make examinations of thrift holding companies. In examining holding companies, the FRB is required to coordinate with other regulators and avoid duplication. Section 604(i) modifies the definition of savings and loan holding company under the Home Owners Loan Act (HOLA)⁹ to

⁵ Act of Nov. 12, 1999, P.L. 106-102.

⁶ The term "functionally regulated subsidiary" of a bank holding company is defined in 12 U.S.C. § 1844(c)(5) to mean a bank holding company subsidiary which is not a bank holding company or depository institution. Such a subsidiary may be a broker or dealer registered under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq.; an investment advisor registered with the SEC or any state; an investment company registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq.; an insurance company subject to supervision by a state insurance regulator; or an entity subject to regulation by the Commodity Futures Trading Commission "with respect to the commodities activities of such entity....". *Id.*

⁷ P.L. 106-102, tit. I, subtit. B., sec. 112, 113 Stat. 1338, added section 10A to the Federal Reserve Act, 12 U.S.C. § 1849. Under this provision, prior to the enactment of the Dodd-Frank legislation, the FRB was precluded from taking action against a functionally regulated subsidiary of a bank holding company unless the action was necessary to address an unsafe or unsound practice posing a material risk to an affiliated depository institution or the payment system and the FRB finds that an action against the affiliated depository institution or depository institutions in general would not provide adequate protection against the material risk.

⁸ The specific language, found in section 604(c), reads: "an entity that is subject to regulation by, or registration with, the Commodity Futures Trading Commission, with respect to activities conducted as a futures commission merchant, commodity trading adviser, commodity pool, commodity pool operator, swap execution facility, swap data repository, swap dealer, major swap participant, and activities that are incidental to such commodities and swaps activities."

⁹ Act of June 13, 1933, c. 64, 48 Stat. 128, 12 U.S.C. §§ 1461 et seq.

exclude bank holding companies, intermediate holding companies, and companies controlling a savings association “that functions solely in a trust or fiduciary capacity.”

Risk to Financial System Must Be Considered in the Context of Any Holding Company Acquisition or Merger

Section 604(d) amends the BHC Act to require the FRB to consider, in addition to other enumerated factors,¹⁰ the potential risks to the U.S. banking system or U.S. financial stability of any proposed acquisition, merger, or consolidation. Section 604(e) amends a provision of the BHC Act which permits financial holding company acquisitions of nonbanking concerns without prior notice to require prior notice for acquisitions involving savings associations and to require FRB approval for acquisitions involving assets of \$10 billion or more.¹¹

Standards for FRB Examination of Holding Company Subsidiaries

Section 605 sets standards for the FRB examination of non-depository, non-functionally regulated subsidiaries of depository institution holding companies by requiring that the examination cover “the activities ... that are permissible for the insured depository institution subsidiaries of the depository institution holding company in the same manner, subject to the same standards, and with the same frequency as would be required if such activities were conducted by the lead insured depository institution subsidiary of the holding company.” If the FRB does not conduct such an examination, the regulator of the lead depository institution may provide the FRB with a written recommendation to conduct such an examination. If the FRB fails to begin such an examination or provide an explanation for not doing so within 60 days of receiving such a recommendation, the regulator of the lead depository institution may commence to conduct the examination. The focus of the examination is to determine whether the activities of these non-functionally regulated, non-depository institution subsidiaries of the holding company materially threaten a depository institution or the holding company, accord with law, and are subject to appropriate risk management systems. Such examinations are to be coordinated with the FRB not only to avoid duplication and share information but also to eliminate the possibility of “conflicting supervisory demands.” Recommendations for supervisory actions are to be submitted to the FRB; if the FRB does not take enforcement action within 60 days, the agency making the recommendation may take action. Before taking any supervisory action against a non-depository, non-functionally regulated subsidiary, notice is to be provided to the appropriate state or federal regulator. Fees may be assessed as necessary for the cost of examinations by the regulator of the holding company’s lead depository institution.

Increased Standards for a Bank Holding Company to Commence to Engage in Financial Activities or to Complete an Interstate Merger or Acquisition

Section 606 amends the BHC Act to add to the requirements for engaging in financial activities as a financial holding company a specification that the holding company (as well as its subsidiary

¹⁰ The types of factors to be considered include competitive factors, supervisory factors, treatment of certain bank stock loans, managerial resources, and money laundering.

¹¹ For Hart-Scott-Rodino (antitrust filing under 15 U.S.C. § 18a(c)(8)) purposes, such acquisitions are to be treated as if FRB approval is not required.

depository institutions as required under GLBA) be well capitalized and well managed. This section contains a provision authorizing savings and loan holding companies to engage in activities that are permissible for financial holding companies provided they meet all the requirements and conduct the activities subject to the same regime as is applicable to financial holding companies.

Section 607 amends the BHC Act and the Bank Merger Act¹² to increase the capital standards for interstate acquisitions of a bank by a bank holding company or interstate bank mergers by requiring that the bank holding company or, in the case of mergers, the resulting bank be well managed and well capitalized.

Increased Restrictions on Interaffiliate Transactions Within Holding Companies

Section 608 amends sections 23A¹³ and 23B¹⁴ of the Federal Reserve Act,¹⁵ which impose restrictions on interaffiliate transactions between member banks (and their subsidiaries) and their bank holding company or any of their holding company affiliates, by expanding the transactions covered under section 23A. For example, purchases of assets subject to repurchase agreements are included within the category of extensions of credit, and there is no authority for the FRB to exempt purchases of real or personal property within this category. Securities borrowing and derivative transactions also are covered to the extent of any credit exposure of the member bank to the affiliate. Section 608 also limits the FRB's authority to grant exemptions by removing the FRB's authority to grant an exemption for a transaction by order, thus, requiring all exemptions to be by regulation. It provides the FRB with authority to determine, jointly with the appropriate federal banking agency, how to calculate the amount of a covered transaction in the case of netting agreements. Before any exemption may take effect, the FDIC must be notified and not object in writing within 60 days of notice on the basis of the exemption's presenting "an unacceptable risk to the Deposit Insurance Fund." It also provides authority for the FRB and the OCC or the FDIC to grant exemptions for a transaction by national banks or state-chartered banks, provided that there is a finding that the exemption is in the public interest and the FDIC determines that the exemption does not present "an unacceptable risk to the Deposit Insurance Fund."

Section 608 also amends section 23B of the FRA to further reduce the FRB's flexibility in granting exceptions to the requirements that interaffiliate transactions under the BHC Act be on market terms by requiring that the FRB notify the FDIC and not receive a written objection from the FDIC within 60 days of notice that contends that the proposed exception presents "an unacceptable risk to the Deposit Insurance Fund."

Similar amendments are added to the HOLA transactions involving savings associations and savings and loan holding companies.

¹² 12 U.S.C. § 1828(c).

¹³ 12 U.S.C. § 371c.

¹⁴ 12 U.S.C. § 371c-1.

¹⁵ Act of December 23, 1913, ch. 6, 38 Stat. 251, 12 U.S.C. §§ 221 et seq.

Section 609. makes transactions between banks and their subsidiaries subject to FRA section 23A by removing an exemption for transactions entered into after enactment, effective one year after the transfer date, i.e., the date on which OTS functions are actually assumed by the transferee agencies.¹⁶

Lending Limits

Section 610 includes within the lending limits applicable to national banks, and, thus, to limits on loans to one person or insiders and interaffiliate transactions, any credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending or borrowing transactions.

Derivative Transactions by State-Chartered Banks

Section 611 permits state-chartered banks to engage in derivative transactions only if the law of the bank's chartering state "takes into consideration credit exposure to derivative transactions."

Charter Conversions by Institutions Under Enforcement Order

Section 612 prohibits depository institutions from converting from one charter—state to federal or vice-versa or thrift to bank—while under a formal enforcement order or a memorandum of understanding unless the proposed new regulator notifies the prospective former regulator that a conversion is proposed and of a plan to address the supervisory concerns, and the former regulator does not object. The new regulator must see to it that the plan is implemented. If there has been a final enforcement action by a state attorney general, the conversion must be conditioned on compliance with its requirements.

De Novo Interstate Branching

Section 613 expands the authority of banks to establish *de novo* branches on an interstate basis to permit *de novo* branching to any location in a state allowed for branching by an in-state bank. No longer will state laws placing conditions on *de novo* branching by out-of-state banks act as a bar to an out-of-state bank wishing to establish its first branch in the state.¹⁷

Loans to Insiders

Section 614 adds credit exposure by virtue of derivative transactions, reverse repurchase agreements, securities lending or borrowing transactions to the restrictions on loans by member banks to insiders; authorizes the FRB to issue implementing rules; and requires the FRB to consult with OCC and FDIC when doing so.

¹⁶ Under section 311 of the Dodd-Frank legislation, the transfer date is to take place one year of enactment unless the Secretary of the Treasury notifies the House Financial Services Committee and the Senate Committee on Banking, Housing, and Urban Affairs of a transfer date within the succeeding 18 months and provides information on why the transfer cannot be effectuated within the year and what steps are being taken to meet the new transfer date in an orderly fashion.

¹⁷ 12 U.S.C. §§ 36(g) and 1831u(b) set conditions on interstate *de novo* branching by out-of-state national and state-chartered banks, respectively.

Countercyclical Capital Requirements

Section 616 amends the BHC Act, the Savings & Loan Holding Company Act,¹⁸ and the International Lending Supervision Act of 1983¹⁹ to require the federal banking regulators to make capital “requirements countercyclical, so that the amount of capital required to be maintained by a [holding company, insured depository institution] ... increases in times of economic expansion and decreases in times of economic contraction, consistent with ... safety and soundness” The section also adds a new section 38A to the FDI Act to specify that the federal regulators of bank holding companies and savings and loan holding companies or any depository institution controlled by any company that is neither a bank holding company nor a savings and loan holding company must require them “to serve as a source of financial strength for any depository institution subsidiary.” The regulators are to issue implementing rules to this effect within a year of enactment. Section 616 also authorizes the regulators to require reports under oath from such companies in order to assess the ability of the company to comply with the law and to enforce compliance. For this purpose “source of financial strength” is the “ability ... to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution.”

Elimination of SEC-Regulated Investment Bank Holding Company; Establishment of FRB-Regulated Securities Holding Company

Section 617 eliminates the investment bank holding company framework in section 17 of the Securities Exchange Act of 1934,²⁰ under which a securities firm not having a depository institution subsidiary may choose to be supervised by the SEC as an investment bank holding company, coincidentally satisfying a foreign law requirement for consolidated supervision by its home country. The securities holding company regime established in section 618 serves as a replacement.

Section 618 establishes a framework whereby a securities holding company may submit to FRB regulation as a supervised securities holding company. Under this provision, “a person (other than a natural person) that owns or controls 1 or more brokers or dealers registered with the ... [SEC]... and the associated persons” may elect to register with FRB and, thereby, meet a foreign regulator’s requirement for supervision on a consolidated basis. A securities holding company would then become subject to the recordkeeping, reporting, and examination requirements imposed by the FRB as specified in section 618. This section provides the FRB with a full range of civil enforcement authority under section 8 of the FDI Act; authorizes it to apply BHC Act requirements on the company; and requires the FRB to prescribe capital and risk management standards, taking into account the differences in types of business, financial assets, liabilities, off-balance sheet exposure, transactions and relationships with other financial companies, importance as a source of credit and liquidity, and the scope of activities of the supervised securities holding company.

¹⁸ 12 U.S.C. § 1730a.

¹⁹ P.L. 98-181, tit. IX, § 901, 97 Stat. 1278, 12 U.S.C. § 3901 note.

²⁰ 15 U.S.C. § 78q.

The “Volcker Rule” Provision²¹

Overview

Section 619 includes certain prohibitions on proprietary trading and hedge fund investments by banking companies. Subsection (a) contains an outright prohibition on proprietary trading by and ownership of interests in or sponsorship of hedge funds or private equity funds by a “banking entity.” “Banking entity” is defined in subsection (h) to mean any FDIC-insured depository institution, company controlling an insured depository institution, company treated as a bank holding company for purposes of the International Banking Act of 1978, and any affiliate or subsidiary of such entity.²² The exact language provides a broad prohibition. It reads: “a banking entity shall not ... engage in proprietary trading, or ... acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.” There are, however, certain exceptions, some transitional and others designated as permitted activities under subsection (d) of the legislation.

Rather than subjecting nonfinancial companies supervised by the FRB to a prohibition on proprietary trading and hedge fund ownership or sponsorship, the legislation authorizes the regulators to issue rules subjecting such companies to additional capital and quantitative limits on such activities unless the activity has been identified as a permitted activity under section (d) and has not been subjected to capital and quantitative requirements for safety and soundness purposes.

Subsection 619(h) sets forth definitions of various terms, in some cases providing a degree of discretion to the regulators to expand the reach of the prohibitions and limitations. For example:

A “hedge fund” or a “private equity fund” is defined as “an issuer that would be an investment company ... but for section 3(c)(1) or 3(c)(7) of [the Investment Company Act of 1940], or such similar funds as the ... [appropriate regulatory agencies] may, by rule, ... determine.”²³

“Proprietary trading” is “engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate ... agencies ... may, by rule ... , determine.”²⁴

²¹ See CRS Report R41298, *The “Volcker Rule”: Proposals to Limit “Speculative” Proprietary Trading by Banks*, by David H. Carpenter and M. Maureen Murphy.

²² Excluded from the definition of “banking entity” are institutions functioning solely in a trust capacity under specified conditions: substantially all the deposits must be in trust funds; none of its insured deposits are marketed through an affiliate; no demand deposits are accepted or commercial loans made; and the institution does not accept payment, discount, or borrowing services from the Federal Reserve banks.

²³ Emphasis supplied.

²⁴ Emphasis supplied.

Financial Stability Oversight Council Study on Implementation of Restrictions on Proprietary Trading and Investment in Hedge Funds and Private Equity Funds

Subsection 619 (b) requires the Financial Stability Oversight Council to complete a study not later than six months after enactment and make recommendations on how implementation may be geared to (1) promote banking entity safety and soundness; (2) limit inappropriate transfers to “unregulated entities” of the federal subsidies embodied in FDIC deposit insurance and FRS liquidity programs; (3) “protect taxpayers and consumers and enhance financial stability” by minimizing risky activities by banking entities; (4) reduce conflicts of interest between customer interests and the self-interest of the covered entities; (5) limit unduly risky activities of the covered entities; (6) accommodate insurance company investment authority while safeguarding both affiliated banking entities and the financial stability of the United States;²⁵ and (7) devise appropriate timing for divestiture of illiquid assets affected by implementation of section 619.

Joint Rulemaking

Subsection 619(b) requires the federal banking regulators and the SEC and CFTC to conduct joint rulemaking and to adopt these rules no later than nine months after the Council completes its study. The regulators must coordinate the regulations for safety and soundness and elimination of the possibility of advantaging or disadvantaging some companies. Subsection (c) specifies that final rules are to become effective the earlier of (1) 12 months after they are issued or (2) two years after enactment.

Divestiture of Non-Conforming Activities Within Two Years

In general, banking entities will be given two years to divest nonconforming activities. Subsection 619(c) requires divestiture of nonconforming activities generally within two years of enactment subject to certain exceptions. The FRB is to issue rules on the divestiture provisions within six months of enactment. Additional capital and other restrictions, including margin requirements, on ownership interests in or sponsorship of hedge funds or private equity funds by banking entities are to be implemented by rules promulgated within the context of the joint rulemaking. The two-year divestiture requirement may be extended under certain circumstances: (1) the FRB may approve extensions for one-year periods not to exceed three additional years, and (2) if a contractual obligation in effect on May 1, 2010, requires a banking entity to take or retain its ownership interest in, or provide additional capital to, an illiquid fund, the entity may apply to the FRB for an extension which may be granted for no more than five years; divestiture would be required at the end of the five years or on the contractual date—whichever is earlier.

Exceptions

Subsection 619(d) identifies exceptions to the blanket prohibitions of subsection 619(a) by listing permitted activities and setting conditions under which those activities may be conducted. It

²⁵ The actual language reads: “appropriately accommodate the business of insurance within an insurance company subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system.”

excludes from permitted activities any transaction or class of activities, otherwise permitted, that would involve or result in a material conflict of interest; a material exposure by the banking entity to “high-risk assets or high-risk trading strategies” as defined by the regulators; or a threat to safety and soundness of the banking entity or to the financial stability of the United States. It provides standards by which the regulators may set further limits or conditions on these activities and includes authority for the regulators to add to the list of permitted activities. The regulators may impose additional capital and quantitative limits as “appropriate to protect the safety and soundness of banking entities engaged in such activities.” Among the conditions specified for conducting these activities are that the activity must (1) be permitted under other federal or state law; (2) be subjected to restrictions as determined by the appropriate federal regulators; and (3) not involve or result in a material conflict of interest, expose the banking entity to “high-risk assets or high-risk trading strategies,” or threaten safety and soundness of the banking entity or the financial stability of the United States. Subject to those conditions, the exceptions or permitted activities are:

- **Government and GSE Obligations.** Subsection (d)(1)(A) authorizes the purchase and sale of U.S. obligations; obligations of federal agencies; obligations of Ginnie Mae, Fannie Mae, Federal Home Loan Banks, Farmer Mac, and Farm Credit System institutions; and obligations of any state or political subdivision of a state.
- **Market Making Activities.** Subsection (d)(1)(B) authorizes the “purchase, sale, acquisition, or disposition of securities and various instruments which the regulators have determined by rule to fall within the definition of “proprietary trading” under subsection (h)(4), provided the transactions are “in connection with underwriting or market-making related activities, to the extent that ... [such transactions] are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.”
- **Risk Mitigating Hedging Activities.** Subsection (d)(1)(C) authorizes “risk-mitigating hedging activities” that are related to “positions, contracts, or other holdings of the banking entity and are designed to reduce specific risks in connection with and related to such holdings.
- **Small Business Investment Company Investments.** Subsection (d)(1)(E) authorizes specified small business investment company investments and investments qualified as rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure as defined in section 47 of the Internal Revenue Code or similar state historic tax credit program.
- **Insurance Company Portfolio Investments.** Subsection (d)(1)(F) authorizes the “purchase, sale, acquisition, or disposition of securities and other instruments” which the regulators have determined by rule to fall within the definition of “proprietary trading” under subsection (h)(4) if the transactions are “by a regulated insurance company directly engaged in the business of insurance for the general account of the company by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company.” The transactions must also comply with applicable law, regulation, or guidance, and there must be no determination by the regulators that a relevant law, regulation, or guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.

- **Proprietary Trading by Foreign Companies Conducted Outside the United States.** Subsections (d)(1)(H) and (I) authorize investments permitted under sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act,²⁶ provided they are conducted solely outside the United States by a company not controlled directly or indirectly by a company organized under the laws of the United States or of a state.
- **Other Investments.** Subsection (d)(1)(J) provides the regulators with authority to permit “[s]uch other activity ... by rule, ... [as] would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.”

Exceptions to the Ban on Investing in Hedge Funds or Private Equity Funds

Subsection 619(d)(1)(G) authorizes banking entities to organize and offer private equity or hedge funds only if (1) the banking entity provides “bona fide trust, fiduciary, or investment advisory services”; (2) the fund is offered only in connection with trust, fiduciary, or investment advisory services to “persons that are customers of such services of the banking entity”; (3) the banking entity retains only a de minimis interest in the funds;²⁷ (4) the banking entity and its affiliates engage in no transaction with the fund that would be designated as a covered transaction under FRA section 23A and other transactions with the fund are conducted only on terms specified in FRA section 23B, as if the banking entity were a member bank, and the fund an affiliate of that bank; (5) the banking entity does not guaranty the obligations of the hedge fund or private equity fund; (6) the banking entity does not share a name with the hedge fund or private equity fund; (7) no director or employee of the banking entity, other than a director or employee directly engaged in providing investment advisory or other services to the hedge fund or private equity fund, takes or retains an interest in the fund; and (8) the banking entity takes certain steps to assure the investors in the hedge fund or private equity fund that losses of the fund will be borne solely by its investors.

De Minimis Investment in Hedge Fund or Private Equity Fund

Subsection 619(d)(4) permits banking entities, subject to certain limitations, to make and retain a “de minimis investment” in a hedge fund or private equity fund or to make an initial investment in a hedge fund or private equity fund that the banking entity organizes. Among the limitations is a requirement to seek unaffiliated investors to reduce, within one year (subject to a possible extension for two more years), the banking entity’s initial investment to the prescribed de minimis amount, as defined in subsection (d)(4). A de minimis investment must be (1) “not more than 3 percent of the total ownership interests of the fund,” (2) “immaterial to the banking entity, as defined by rule,” and (3) such that the aggregate investment of the banking entity in all such funds does not exceed 3% of its Tier 1 capital. There is also a requirement that a banking entity’s aggregate outstanding de minimis or initial investments in hedge funds or private equity funds organized by the banking entity, including retained earnings, must be deducted from assets and

²⁶ 12 U.S.C. §§ 1843(c)(3) and 1843(c)(9).

²⁷ A de minimis investment, as defined in subsection (d)(4), is “not more than 3 percent of the total ownership interests of the fund,” and “immaterial to the banking entity, as defined by rule” but such that the aggregate investment of the banking entity in all such funds does not exceed 3% of its Tier 1 capital.

tangible equity of the banking entity and the amount of the deduction to “increase commensurate with the leverage of the hedge fund or private equity fund.”

Under subsection 619(f), a banking entity serving as “an investment manager, investment advisor, or investment sponsor to a hedge fund or private equity fund” or a banking entity which organizes and offers a hedge fund or private equity fund in connection with fiduciary or trust services as specified in subsection (d)(1)(G) or any affiliates thereof may enter into a transaction with the fund which would be a covered transaction under FRA section 23A if the banking entity and affiliate were a member bank and the fund were an affiliate thereof. In addition, any transaction between the banking entity and the fund must comply with Section 23B of the FRA as if the banking entity were a member bank and the fund, an affiliate, thereof. The FRB may permit a banking entity to enter into a prime brokerage transaction with any hedge fund or private equity fund in which a hedge fund or private equity fund managed, sponsored, or advised by the banking entity or nonbank financial company has an ownership interest under certain conditions. The banking entity must be in compliance with all of the conditions under which a banking entity may organize and advise a hedge fund or private equity fund in connection with fiduciary or trust services under subsection (d)(1)(G). Moreover, the banking entity’s chief executive officer must provide an annual, and updated as necessary, written certification of compliance. The FRB must have determined that the primary brokerage agreement is consistent with the safe and sound operation of the banking entity; moreover, the prime brokerage transaction is subject to FRA section 23B as if the counterparty were an affiliate of the banking entity. Additional capital charges or other restrictions for nonbank financial companies are to be covered by rules issued by the appropriate regulators in the prescribed joint rulemaking proceedings.

Regulatory Authority to Grant Exceptions and Rules of Statutory Construction

Subsection 619(d)(1)(J) provides the regulators with authority to permit “[s]uch other activity ... by rule, ... [as] would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.”

Subsection 619(g) provides three rules of statutory construction for interpreting section 619: (1) the prohibitions and restrictions of section 619 apply, except as provided in the section, notwithstanding the existence of other provisions of law authorizing such activities; (2) nothing in section 619 is to “be construed to limit the ability of a banking entity or nonbank financial company ... to sell or securitize loans in a manner otherwise permitted by law”; and (3) nothing in section 619 is to “be construed to limit the inherent authority of any Federal agency or State regulatory authority under otherwise applicable provisions of law.”

Evasions

Subsection 619(e) authorizes the appropriate regulator, having reasonable cause to believe that a banking entity or a nonbank financial company supervised by the FRB, is engaged in activities functioning as an evasion of section 619, or in violation of section 619, to order, subject to notice and opportunity for a hearing, termination of the activity and disposition of the investment. This subsection also requires the regulators to issue internal control and recordkeeping rules to insure compliance with section 619.

Report

Section 620 requires the federal banking agencies to prepare a joint report within 18 months of enactment on the investments and activities which banking companies may engage in under federal and state law, focusing on the types of activities, associated risks, and risk mitigation activities. The report is to be forwarded to the House Committee on Banking and Financial Services and the Senate Banking, Housing and Urban Affairs Committee two months after its completion with recommendations on whether activities present safety and soundness risks to banking concerns or to the U.S. financial systems, whether each investment or activity is appropriate, and any additional necessary restrictions.

Conflicts of Interests Relating to Certain Securitizations

Section 621 prohibits, subject to certain exceptions, asset-backed securities underwriters and sponsors and related entities from engaging in transactions with investors in those securities under circumstances giving rise to a conflict of interest and requires the SEC to issue implementing rules. Specifically, section 621 amends the Securities Act of 1933²⁸ to prohibit any “underwriter, placement agent, initial purchaser, or sponsor or any affiliate or subsidiary of any such entity, of an asset-backed security ...at any time for ... one year after the date of the first closing of the sale of the asset-backed security [from engaging in] any transaction that would involve in or result in any material conflict of interest with respect to any investor in a transaction arising out of such activities.” The SEC is to issue rules within 270 days of enactment to implement this provision. There are specific exceptions for risk-mitigating hedging activities designed to reduce related risks and for purchases of the securities made pursuant to and consistent with commitments to provide liquidity for the security or market making for the security.

Concentration Limit of 10% of Aggregated Consolidated Assets of All Financial Companies

Section 622 prohibits any insured depository institution, bank holding company, savings and loan holding company, company controlling an insured depository institution, nonbank financial company supervised by the FRB, or any foreign bank or company treated as a bank holding company to merge or acquire assets of another company if the total consolidated liabilities of the acquiring company upon consummation of the transaction exceeds 10% of the aggregate consolidated liabilities of all financial companies at the end of the previous calendar year. The FRB may make exceptions with respect to the acquisition of a bank in default, an acquisition involving assistance provided by the FDIC under its authority to provide assistance to insured depository institutions in danger of default or during severe financial conditions under 12 U.S.C. § 1823(c), or an acquisition that results in minimal increase in the company’s liabilities. Rulemaking authority is provided to the FRB; however, the rules must be “in accordance with the recommendations of the Council” after the Council completes a study on the potential effect of this concentration limit. The Council is to complete its study within six months of enactment; the FRB, to issue rules within nine months thereafter.

²⁸ 15 U.S.C. §§ 77a et seq.

Section 623 amends the FDIA, the BHC Act, and the Savings and Loan Holding Company Act to prohibit the federal banking agencies from approving any application for an interstate merger transaction in which the resulting depository institution, bank holding company, or savings and loan holding company would control more than 10% of the total amount of deposits of insured depository institutions in the United States. There are exceptions for acquisitions of a depository institution in default or involving assistance provided by the FDIC under its authority under 12 U.S.C. § 1823(c) to provide assistance to insured depository institutions in danger of default or during severe financial conditions and for transactions resulting in only a minimal increase in the liabilities of the financial company.

Qualified Thrift Lenders

Section 624 applies to savings associations which fail to remain qualified thrift lenders, i.e., to qualify as a domestic building and loan association under 26 U.S.C. § 7701(a)(19) or generally to maintain 65% or more of portfolio assets in qualified thrift investments. It adds to the restrictions in place prior to enactment of the Dodd-Frank legislation a provision that limits their ability to pay dividends unless they are permissible for a national bank; necessary to meet obligations of the company which controls the savings association; and are specifically approved by OCC. The OCC may employ a full range of enforcement authority, under section 8 of the FDIA, against a savings association failing to remain a qualified thrift lender, which is deemed to be a violation of section 5 of the Home Owners' Loan Act, 12 U.S.C. § 1464.

Treatment of Dividends by Certain Mutual Holding Companies

Section 625 imposes restrictions on the declaration or waiver of dividends by mutual holding companies. It requires every savings association subsidiary of a mutual holding company to provide the appropriate federal banking agency and the FRB 30-days' notice before declaring a dividend on any nonwithdrawable stock of the savings association. It permits a mutual holding company to waive dividends declared by a subsidiary if (1) no insider or tax-qualified or non-tax-qualified employee stock benefit plan of the mutual holding company holds any of the subject stock or (2) the FRB is given 30-days' notice of the intended waiver and the FRB does not object. The FRB may object to the waiver only on the following grounds; (1) the waiver would be detrimental to the safe and sound operation of the savings association; (2) the mutual holding company's board of directors has not determined that the waiver is consistent with its fiduciary duties to the mutual members of the holding company; or (3) prior to December 1, 2009, the mutual holding company reorganized into a mutual holding company, issued minority stock from its mid-tier stock holding company or its subsidiary stock savings association, and waived dividends which it had a right to receive from the subsidiary stock savings association.

Intermediate Holding Company for Unitary Thrift Holding Companies

Section 626 authorizes the FRB to require a grandfathered unitary thrift holding company which conducts commercial or manufacturing activities or other non-financial activities in addition to financial activities to conduct all or part of its financial activities in an intermediate savings and loan holding company. If the FRB determines that the establishment of such an intermediate holding company is necessary to supervise the financial activities or to keep the FRB from supervising the non-financial activities, it must establish an intermediate holding company.

Financial activities that are internal to the company need not be placed in the intermediate holding company if the FRB finds that the grandfathered unitary thrift holding company engaged in the activities during the year prior to enactment and at least 2/3's of the assets or revenues generated from the activities are attributable to the grandfathered unitary thrift holding company. If an intermediate holding company is required, the grandfathered unitary thrift holding company must serve as a source of strength for it; the FRB may require periodic reports from the parent company. The FRB is required to issue regulations regarding interaffiliate transactions between the intermediate holding company and its parent and non-subsidiary affiliates, but it may not "restrict or limit any transaction in connection with the bona fide acquisition or lease by an unaffiliated person of assets, goods, or services." FRB may use the full array of enforcement authorities under section 8 of the FDIA to enforce the provisions of the section against the grandfathered unitary thrift holding company. A savings clause states that nothing in the section is to be construed as requiring a unitary savings and loan holding company to conform its activities to those permissible for a savings and loan holding company, i.e., to divest its non-conforming commercial or manufacturing activities.

Interest on Business Checking Accounts

Section 627 repeals the prohibition applicable to banks and thrifts on paying interest on business checking accounts, effective one year after enactment.

Credit Card Bank Small Business Lending

Section 628 permits credit card banks to make one kind of commercial loan without satisfying the BHC Act definition of "bank," and, thereby, being subject to FRB regulation on a consolidated basis. The type of loan authorized is credit card loans to small businesses meeting the Small Business Administration eligibility criteria for business loans under 13 C.F.R., Part 121.²⁹

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²⁹ The Small Business Administration regulations include a table setting size standards for various businesses (13 C.F.R. § 121.201); some are stated in millions of dollars, others in numbers of employees.