

Regulation of Tier 1 Financial Holding Companies

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SYSTEMIC RISK REGULATOR

- Proposal to regulate Tier 1 financial holding companies is based on concerns about systemic risk
- Systemic risk comes in two forms:
 - Pervasive credit risk that could lead to domino failures
 - Panic

SYSTEMIC RISK

- Fed originally created to address systemic risk
 - Currency Panic of 1907
 - Discount window, open market operations and currency issuance were designed to address the economic effects of systemic risk

SYSTEMIC RISK

- Administration proposal
 - Systemic risk regulator
 - Designed to prevent systemic events

SYSTEMIC RISK

- Financial Services Oversight Council
 - Treasury
 - Fed
 - National Bank Supervisor
 - CFPA
 - SEC
 - CFTC
 - FDIC
 - FHA
- Advisory

TIER 1 FINANCIAL HOLDING COMPANIES

- Tier 1 Financial Holding Company
 - Regulated by the Fed
 - Not limited to bank holding companies
- Prudential standards to maximize financial stability at least cost to long-term financial and economic growth
 - More stringent than BHC standards
 - Risk-based capital
 - Leverage limits
 - Liquidity requirements
 - Overall risk management requirements

TIER 1 FINANCIAL HOLDING COMPANIES

- Activity limitations
 - Same as BHCA after 5-year Phase In
- Financial activities
 - Banking
 - Insurance
 - Securities
 - Laundry list activities
 - Finder
- Divestiture generally required for non-financial activities

TIER 1 FINANCIAL HOLDING COMPANIES

- Criteria
 - Financial assets
 - Liabilities, including the degree of reliance on short-term funding
 - Off-balance sheet exposures
 - Transactions or relationships with other major financial companies
 - Importance as a source of credit and liquidity
 - Recommendation of the Financial Services Oversight Council
 - Other factors that the Fed deems appropriate

TIER 1 FINANCIAL HOLDING COMPANIES

- Possible indicia
 - \$10 billion or more in assets
 - \$100 billion or more in assets under management
 - \$2 billion or more in gross annual revenue

REGULATORY STRUCTURE

- Based on Bank Holding Company Act (“BHCA”)
- Umbrella holding company regulator
- Must have a “company”
 - An individual is not a company
- May have different regulators for different subsidiaries
- Activity limitations
- Holding in non-financial companies limited to 5% of voting securities or assets

CONTROL OF A TIER 1 FINANCIAL HOLDING COMPANY

- Whether a company “controls” the Tier 1 financial holding company and is therefore a Tier 1 financial holding company itself depends on the definition of control
 - Ownership of 25% or more of the voting securities of a company;
 - Majority of board seats; or
 - Otherwise exercising a controlling influence over management and policies of a bank
- Ownership of 9.9% or less of voting securities is generally considered not to be a control position

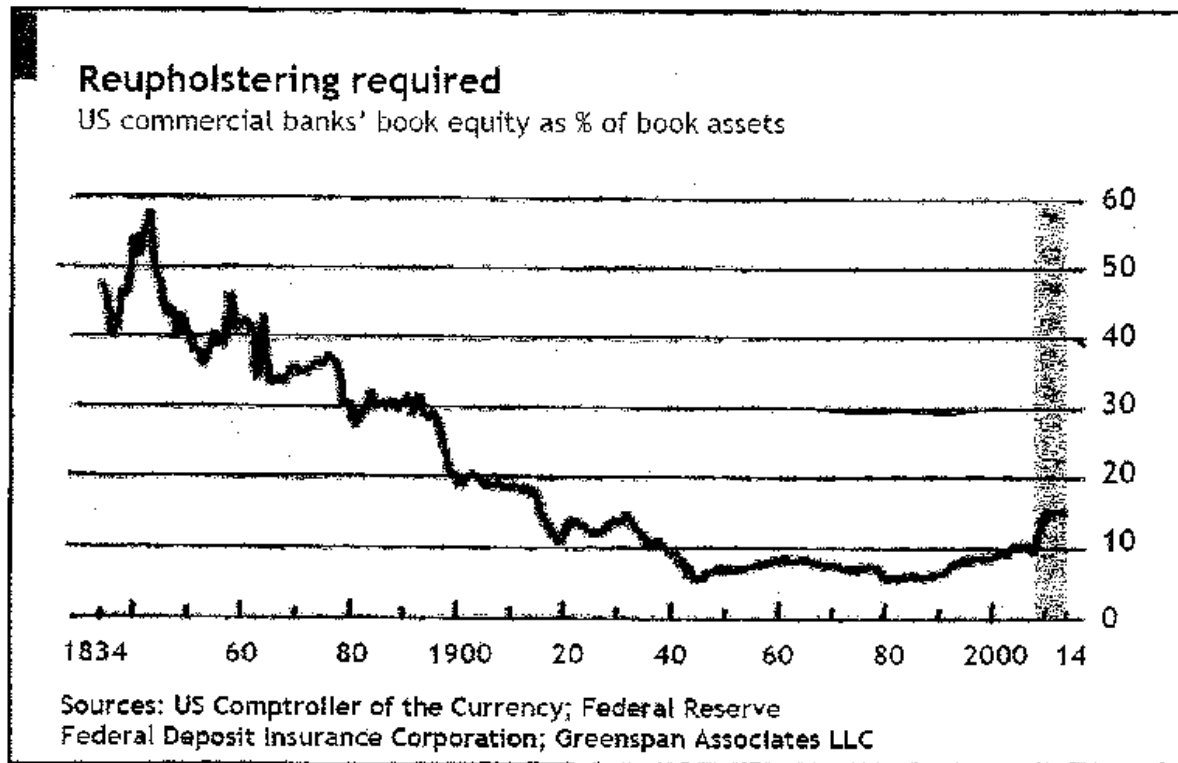
CONTROL

- Holding between 10% and 24.9% of the voting securities – the so-called “mezzanine” – a complex set of Fed rules and presumptions apply to determine control
- To avoid control in the mezzanine, the company will need to satisfy the Fed that it does not exercise a controlling influence over a company

Consequences of FHC Status

- Supervision and examination by the Fed
 - Accounting standards
 - Adequate internal controls
 - Adequate management and governance
- Reporting requirements that may require accounting system changes
- Leverage and risk-based capital requirements
 - Prior Fed approval to redeem stock in certain circumstances

HISTORY OF CAPITAL REQUIREMENTS



Do Consequences of Bank Ownership Apply

- Restrictions on transactions with affiliates
 - Apply to transition “silo” company
- “Source of strength” doctrine—
 - Probably does not apply to a Tier 1 financial holding company that is not a bank holding company
- Limitations on dividends