

ABA Overview of Proposed Systemic Risk Legislation
Oct. 28, 2009

The House Financial Services Committee and Treasury recently released a discussion draft of legislation that addresses issues of systemic risk and resolution of large, complex financial institutions. This bill is consistent with many of the principles identified by the ABA's Regulatory Restructuring Task Force, although there is still much work to be done. Highlights of the draft include the following:

Enhanced systemic risk oversight

The discussion draft would create an oversight council that would be charged with monitoring the marketplace for systemic risk, identifying companies and activities that warrant heightened prudential standards, and reporting to Congress. It would be chaired by the Secretary of the Treasury and would have representatives from the banking agencies and other financial regulators on it as well. The Council would not examine or enforce applicable laws with respect to any one institution but would instead focus on identifying issues that threaten the broader economy. The ABA has called for the creation of such a Council and believes this would be a constructive step towards avoiding undetected systemic risk going forward.

Enhanced prudential supervision

The draft would give the Federal Reserve Board significantly expanded powers to monitor, supervise, and examine systemically significant financial institutions. The language prohibits the naming of such institutions, which we believe is wise. The problem of "too big to fail" would only likely get worse if the government were to identify a class of institutions that could be perceived as receiving special treatment. We will work with Congress to ensure that enhanced supervisory powers are balanced with the need of American financial institutions to remain competitive and innovative.

Resolution of systemically significant institutions

The draft addresses what we believe to be an essential part of the solution to today's problems, namely, the ability to wind down the business of any financial institution regardless of size or complexity. We support vesting authority to decide to resolve an institution in Treasury, subject to the considerable safeguards built into the process to ensure that the decision is made only after a thorough deliberation. However, because the draft would assign responsibility to the FDIC for resolving these large institutions, we disagree with the means to achieve the objective. We remain concerned about the possible adverse impact on the public's confidence in the FDIC if additional responsibilities for non-bank institutions are added to the FDIC's already very full plate. The discussion draft contains a funding mechanism that would occur after an institution is resolved, which we support. We will continue to work to ensure that banks not be asked to pay for the costs of resolving nonbanks.

Protection of the thrift charter

The discussion draft established part of the framework that ABA had suggested to maintain the thrift charter, but corrections and changes are essential to maintain a more complete range of options currently available. The draft would abolish the OTS, but maintain mutual and stock federal thrift charters to be regulated under a division of the Comptroller of the Currency, managed by a deputy comptroller. Savings and loan holding companies would be regulated by the Federal Reserve. Statutory provisions provide that federal mutual holding companies can elect to waive dividend payments to the top tier mutual interest, but corrections to statutory language are necessary to make such waivers fully functional. Other changes are essential so that regulation of savings and loan holding companies is more equitable. The current problems were not caused by the existence of four bank regulators, nor will eliminating the OTS solve any problems. We will work with Congress to correct deficiencies in the discussion draft.

“Skin in the Game”

The discussion draft would require originators of mortgage loans to retain a “material portion” of the credit risk, defined as 10% of the credit risk. That level could go as low as 5% but could also be raised to a higher level if the underwriting by a lender is insufficient. Securitizers would have to retain an interest in the underlying assets unless the originator retains such an interest. Sound underwriting of loans clearly is crucial to a lender’s safe and sound operations and the health of the secondary market. However, this requirement will require not only that lenders retain risk but, indirectly, that they hold additional capital to support the risk. This could limit the ability of a bank or savings association to meet the needs of its community. We will work with Congress to try to achieve the appropriate balance in this area.

ABA staff continues to study the bill and will provide additional analyses in the days and weeks to come. We commend Treasury and the House Financial Services Committee for their extraordinary efforts during a difficult period, and we look forward to continuing the dialogue about the many important issues that affect our industry.