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United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Committee Majority Staff

Date: April 11, 2013

Subject: April 16, 2013, Subcommittee on Oversight and Investigations Hearing Entitled "Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?"

The Oversight and Investigations Subcommittee will hold a hearing titled "Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?" at 2:00 p.m. on Tuesday, April 16, 2013, in Room 2128 of the Rayburn House Office Building. This hearing will examine the authority that the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) confers on federal financial regulators to order financial institutions to divest assets or operations, as well as the processes and procedures that regulators are adopting to exercise these authorities.

This will be a one panel hearing with the following witnesses:

- Scott G. Alvarez, General Counsel, Federal Reserve Board of Governors
- Richard J. Osterman, Jr., Acting General Counsel, Federal Deposit Insurance Corporation
- James Wigand, Director, Office of Complex Financial Institutions, Federal Deposit Insurance Corporation

Dodd-Frank Act Section 121: "Mitigation of the Risks to Financial Stability"

Section 121 of the Dodd-Frank Act requires the Federal Reserve Board, in certain circumstances, to impose limits on the activities of large financial companies to mitigate grave threats to the financial system of the United States. Subsection 121(a) directs the Federal Reserve to require a bank holding company with total consolidated assets of $50,000,000,000 or more or a nonbank financial company supervised by the Federal Reserve (collectively, "covered companies"), to undertake mitigating measures if the Federal Reserve determines that the company poses a grave threat to the financial stability of the United States. Before the Federal Reserve can require the covered company to undertake mitigating measures, two-thirds of the voting members of the Financial Stability Oversight Council (FSOC) must approve the Federal Reserve's action.[1] In exercising their authority under Section 121, the Federal Reserve and the FSOC must consider the criteria related to the covered company's financial health and interconnectedness as enumerated in

[1] §121(a).

Section 113, which are the criteria the FSOC considers when designating a nonbank financial company for supervision by the Federal Reserve.[2]

After the Federal Reserve determines that a covered company poses a grave threat to the financial stability of the United States and the FSOC approves the Federal Reserve's determination, Subsection 121(a) requires the Federal Reserve to:

(1) limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company;
(2) restrict the ability of the company to offer a financial product or products;
(3) require the company to terminate one or more activities;
(4) impose conditions on the manner in which the company conducts 1 or more activities; or
(5) if the [Federal Reserve] determines that the actions described in paragraphs (1) through (4) 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.

In consultation with the FSOC, the Federal Reserve must notify a covered company in writing that it is considering restricting the company's activities or ordering it to divest assets.[3] The Federal Reserve is required to provide a "written hearing" if the covered company timely requests one after receiving notice; the Federal Reserve must notify the covered company of its decision, including the results of the FSOC's vote, within 60 days from the hearing date or, if no hearing is requested, within 60 days from the notice date.[4]

The Federal Reserve has not imposed any restrictions on a covered company or ordered such a company to divest assets under Section 121, although a group of consumer advocates, academics, and economists, led by the consumer advocacy organization Public Citizen, has submitted a petition requesting that the Federal Reserve use its authority to order Bank of America to divest certain assets and operations.[5]

Dodd-Frank Act Section 165: "Enhanced Prudential Standards."

Section 165 of the Dodd-Frank Act requires the Federal Reserve to establish heightened prudential standards for covered companies. Congress authorized the Federal Reserve to impose these standards "[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions."[6] Thus, for example, the Federal Reserve must impose risk-based capital requirements and leverage limits, liquidity requirements, risk management requirements, credit exposure requirements, and

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[2] §121(c).
[3] §121(b)(1).
[4] §121(b). In consultation with the FSOC, the Federal Reserve may allow the company to submit oral testimony and make oral argument in connection with the hearing. § 121(b)(2).
[5] "Group calls for U.S. to break up Bank of America," Reuters, Jan. 25, 2012, available at http://www.reuters.com/article/2012/01/25/us-bankofamerica-breakup-idUSTRE80O0NP20120125.
[6] §165(a)(1).

concentration limits on covered companies.[7] The Federal Reserve also may establish "such other prudential standards" as the Federal Reserve, on its own or pursuant to a recommendation by the FSOC, "determines are appropriate."[8]

Section 165 requires covered companies to submit resolution plans known as "living wills." These "living wells" must demonstrate how a covered company could be resolved under the Bankruptcy Code without posing systemic risk to the financial system of the United States and without requiring government assistance.[9] If the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) jointly determine that a company's living will is not credible or would not facilitate an orderly resolution of the covered company under the Bankruptcy Code, the covered company must resubmit a revised living will.[10]

If a covered company fails to timely submit an acceptable revised living will, Subsection 165(d)(5)(A) provides that the Federal Reserve and the FDIC "may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of a covered company[.]" Subsection 165(d)(5)(B) further provides that the Federal Reserve and the FDIC "may jointly direct a [covered company], by order, to divest certain assets or operations . . . to facilitate an orderly resolution" of the company in bankruptcy whenever: (1) more stringent requirements have been imposed under §165(d)(5)(A) and (2) the covered company has failed to submit a credible living will within two years from the date on which such requirements were imposed.

The Federal Reserve and the FDIC have required covered companies to begin submitting living wills in three groups under a staggered schedule. The largest, most complex companies submitted their living wills by July 1, 2012.[11] To date, the Federal Reserve and the FDIC have not determined that any living will submitted by the first group is deficient.[12] Covered companies in the second group will submit living wills by July 1, 2013, and the third group of covered companies will submit their living wills by December 31, 2013.[13]

Other Dodd-Frank Provisions

Other provisions in the Dodd-Frank Act confer authorities that permit federal regulators to order financial institutions to divest assets or operations. For example, Section 166 authorizes the Federal Reserve to order covered companies to take certain "remediation measures," including the divestiture of assets, to minimize both the

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[7] §165(b)(1)(A).
[8] §165(b)(1)(B)(iv).
[9] Resolution Plans Required—Final Rule, Federal Reserve and FDIC, 76 F.R. 67323 (Nov. 1, 2011), available at http://www.fdic.gov/regulations/laws/federal/2011/11FINALNov1.pdf .
[10] §165(d)(4).
[11] Resolution Plans Required—Final Rule, 76 F.R. at 67330.
[12] *See id.* at 67331(noting that "[t]here is no expectation by the [Federal Reserve] and the [FDIC] that the initial resolution plan iterations . . . will be found to be deficient, but rather the initial resolution plans will provide the foundation for developing more robust annual resolution plans over the next few years following that initial period").
[13] *Id.* at 67330.

probability that the company will become insolvent and the potential harm of such insolvency to the financial stability of the United States.[14] In addition, Section 171(b)(7) requires the Federal Reserve, subject to FSOC's recommendations, to develop capital requirements applicable to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve that address the risks that these institutions' activities pose to public and private stakeholders in the event of adverse performance, disruption, or failure of the institution or activity.

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[14] *See also* Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies—Proposed Rule, Federal Reserve, 77 F.R. 594, 637 (Jan. 5, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf .