# Financial Services Management

## Limits on FRB, FDIC Emergency Programs

| Corporate Planning | Risk Management Action Item |
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**Cite**

Dodd-Frank Act

Title XI

**Recommended Distribution**

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**http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ203.111.pdf**

### Overview

In this report, FedFin assesses Title XI of the Dodd-Frank Act, which significantly curtails the degree to which the Federal Reserve and FDIC can provide emergency assistance in future financial-market crises. Public attention during action on the legislation focused principally on whether the GAO could audit the FRB's monetary-policy operations. The final law here is considerably tempered, but other aspects of it have far-reaching impact often overlooked. The significant constraints on FRB and FDIC powers, combined with new disclosures and other standards related even to ordinary discount-window operations, will make it far harder to sustain troubled institutions or for these agencies to support markets in general. Title XI is intended to force insolvent institutions into the new orderly-liquidation framework established in Title II of the Dodd-Frank Act,[1] not permit direct or indirect taxpayer support facilities. Going forward, the FRB will simply be barred from individual-assistance transactions like those used to rescue Bear Stearns and AIG. Even broad market support facilities are banned unless these address liquidity risk (tightly defined). The discount window is now the only facility the FRB may use for individual institutions. However, new disclosure requirements apply

[1] See Client Report SYSTEMIC30, *Financial Services Management*, July 22, 2010.

here, which – while delayed – may further stigmatize this window and reduce use except under extreme stress.

Another aspect of Title XI on which public comment has yet to focus involves additional disclosure requirements, which address central banks with which the FRB has established swap facilities. This may well limit any future structures of this sort, which critics believe provided back-door support to large banks. However, these foreign-currency facilities were used not only in the U.S. financial crisis, but also recently as the European Union faced severe stress, supporting the FRB's view that they are essential to preserve global market stability as long as the dollar is the world's reserve currency. Although perhaps lacking this global impact, new restrictions on the FDIC will also significantly limit this agency's powers in any future crisis, for example by barring any new facility akin to the temporary liquidity guarantee program[2] used by non-banking entities at potential risk to the Deposit Insurance Fund.

## Analysis

### A. Federal Reserve Emergency Powers and Disclosures

#### *1. Limitations*

The law amends Section 13(3) of the Federal Reserve Act to bar assistance in unusual or exigent circumstances to individuals, partnerships or specific corporations (as previously allowed). Instead, the FRB may now only provide support in these circumstances through "broad-based" programs, defined in law.

Rules on how this may be done are required from the FRB (although no deadline is set for them). The FRB must consult with Treasury, with the rules making clear that any emergency support in these broad-based programs is solely for liquidity purposes to stabilize the financial system, not individual firms. Any programs must be structured to protect taxpayers from loss (including through Federal Reserve Bank valuation of all collateral pledged in emergency programs) and include an orderly termination process. These rules must also ensure that no borrowing is done by insolvent entities.

Should the Board use any program established by these rules, it would then need Treasury approval and also have to notify Congress promptly, including disclosure of firms using any such program, the amount of aid provided and similar information. Of particular note is the required disclosure to Congress of the terms of any assistance and whether the recipient adjusted executive compensation as a result. After the initial notice to Congress, the FRB will need to provide ongoing reports every thirty days throughout any such program (with these reports also focusing on potential risk to taxpayers through updated collateral valuations). The FRB may hold some of these data confidential through limited disclosure to Congress.

[2] See Client Report DEPOSITINSURANCE83, *Financial Services Management*, April 16, 2010.

### *2. GAO Audit and Disclosures*

The GAO now may audit all emergency credit facilities established by the FRB, with these audits to focus on factors such as operational integrity so that the GAO does not get into monetary-policy review. These audits are to be provided to Congress ninety days after completion, but these reports may not disclose individual details on program participants until the FRB releases the data one year after program termination. Termination is set two years after the last credit extension provided by the Board (thus blocking the FRB from delaying disclosures solely through failing officially to terminate a program). In general, the FRB itself must disclose data one year after a program is terminated and eight months after each transaction in any of its credit facilities.

In addition to the new audit powers for prospective credit facilities, the GAO must audit any provided by the FRB since December 1, 2007. This must begin no later than thirty days after enactment and conclude twelve months after enactment, with a report then due to Congress. These audits must include not just the special facilities for AIG and Bear Stearns, but also the money-market assistance facility,[3] TALF,[4] swap lines with other central banks, and purchases of GSE obligations. The law also requires the FRB to make public an array of data on these programs by year-end, 2010.

### *3. Discount Window and Other Operations*

The specific disclosures required above are also mandated for any FRB "open-market" operations after enactment, including purchase of obligations and/or discount-window assistance.

### *4. FOIA Exemption*

The inspector-general of the Federal Reserve is to study the exemption from Freedom of Information Act (FOIA) inquiries for information related to all the facilities discussed above unless or until released by the FRB. This report is due thirty months after enactment. Pending litigation is not affected.

## B. FDIC Guarantee

### *1. Determination*

The Treasury Secretary may ask the FDIC and FRB if a "liquidity event" warrants the FDIC guarantee program discussed below. The FDIC could then institute a guarantee program, but only following majority votes by it and the

[3] See Client Report MUTUALFUND46, September 29, 2008.

[4] See Client Reports in the TALF series.

FRB upon agreement by Treasury (in consultation with the President). Documentation related to any such determination will be reviewed by the GAO, which will report to Congress. Congressional notice is also required.

In addition to determining whether a liquidity event should trigger the guarantee, Treasury and the President will decide the amount of any program and notify Congress to that effect. A joint resolution of approval under a process detailed in law is necessary before the FDIC can provide any guarantees or to raise the amount from one previously authorized.

The statute defines "liquidity event," stipulating that it must be an "exceptional and broad reduction" in general financial-market capacity to sell assets, to borrow while using assets as collateral or obtain unsecured credit during "unusual and significant" reductions in market capacity.

### *2. FDIC Program*

Like FRB emergency credit facilities, any FDIC guarantee created due to liquidity events must be widely-available and back only obligations of solvent institutions. Guarantees could only be provided to insured depositories and their holding companies or affiliates (but only if the firm is a BHC or S&LHC). As soon as possible, the FDIC is to set rules for this program in consultation with Treasury. Collateral could be required as a condition of a guarantee, but this is not mandatory (in contrast to the FRB facilities described above).

### *3. Funding*

The FDIC is to charge fees to recoup the cost of any liquidity guarantees, with the FDIC authorized to borrow funds from Treasury if necessary to initiate the guarantee. If fees on participants are insufficient, then a special assessment is permitted, but only on program participants. Back-up special assessments on participants is required if there is any shortfall. Use of the Deposit Insurance Fund for these programs is barred.

### *4. FDIC Claims*

If a bank or holding company defaults on any obligation under this guarantee program or those preceding it, the FDIC must seize the firm and establish itself as receiver. Consideration must then be given to resolving any non-bank parents and/or affiliates under the law's new orderly-liquidation process or through bankruptcy. This provision, combined with the ban on using Deposit Insurance Fund resources to handle losses in these programs, increase the risk to firms using any FDIC programs, including those now in effect.

### *5. FDIC Authority*

This is now constrained to prevent the FDIC from providing debt guarantees other than under the systemic liquidity facility described above, with the FDIC now also barred from providing open-bank assistance to systemic institutions. Open-bank assistance remains possible, however, in the case of individual institutions absent systemic risk.

## C. FRB Governance

### *1. Federal Reserve Bank Presidents*

The law now requires that Class B and C directors (who represent the public), not Class A directors (who represent financial institutions) name a Federal Reserve Bank president. Federal Reserve Bank presidents also have no authority to make decisions related to systemic risk under Title I of the Dodd-Frank Act,[5] thus ensuring that only the Board of Governors decides which firms are systemic and sets the rules that shall govern them. This provision replaces one that would have required Presidential appointment of the president of the Federal Reserve Bank of New York.

### *2. Vice Chair*

A new position of Vice Chair for Supervision and Regulatory Policy is established. Like the general vice chair, this position is filled by appointment of the President and confirmation by the Senate for a four-year term.

### *3. Supervisory Policy*

The Federal Reserve Board may no longer delegate this to regional Reserve Banks.

### *4. GAO Audit*

Within a year of enactment, GAO is to audit governance of the Federal Reserve System. This must evaluate the Banks in general and also review the process for appointing Reserve Bank directors and potential conflicts of interest. This report is due to Congress ninety days after its completion.

[5] See Client Report SYSTEMIC29, *Financial Services Management*, July 13, 2010.

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