This Supplement to the FSSA for the United States (www.imf.org) provides additional information on the financial reform law and recent earnings reports.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 was passed in the Senate on July 15 and signed by the President on July 21. In the main, it is consistent with the earlier House–Senate conference report described in the FSSA:

- **Financial Stability Oversight Council (FSOC):** This improves upon the non-statutory President’s Working Group on Financial Markets, with a structure and accountability framework that seek to balance risks of under- and over-regulation. *Inter alia,* the FSOC will designate systemic nonbank financial firms and financial market utilities.

- **Federal Reserve (Fed) consolidated oversight of systemic financial firms:** The Fed will regulate and supervise designated nonbank financial firms as well as bank holding companies (BHCs), subjecting systemic firms to higher standards, including “living wills” that could trigger mandatory changes to group structure.

- **Special resolution authority:** This strives to create a middle ground between disorderly failure and outright bail out of systemic groups. Intervention could now occur at the holding company level, with management replaced, equity extinguished, and systemic operations transferred to state-owned “bridge” structures.

- **Regulation of derivative markets:** This should bolster market discipline through better transparency and improve stability through new clearing, trade-execution, and business-conduct requirements on swap transactions, as well as capital and margin norms for swap dealers and major swap participants.

- **Infrastructure oversight:** This seeks to address contagion risk by subjecting designated systemic financial market utilities to heightened and uniform risk management standards; utilities not chartered as banks may be granted access to Fedwire and, in unusual and exigent circumstances, to the discount window.
Bureau of Consumer Financial Protection (BCFP): This new agency will assume most extant federal consumer protection functions, with exclusive rule making and examination authorities and primary enforcement powers over large federally insured commercial banks, thrifts, and credit unions.

3. **As noted in the FSSA, the new legislation misses the opportunity to streamline the financial regulatory architecture.** The number of agencies involved actually increases, with three for federal safety-and-soundness oversight of banks and thrifts and two for market regulation of securities and derivatives. In addition, action to close exceptions to consolidated supervision is deferred to a study by the Government Accountability Office (GAO).

4. **The legislation poses a number of important implementation challenges.** The FSOC will need to coordinate nine federal bodies in meeting its systemic risk mandate, and a key responsibility will be to significantly improve inter-agency cooperation and information sharing. In addition, many specific provisions need to be fleshed out and the law will require a very large number of separate and time-bound rulemakings, one-off reports or studies, and new periodic reports. Most notably, the FSOC needs to define systemically risk-sensitive prudential norms for capital, leverage, and liquidity. Moreover, although the special resolution mechanism breaks new ground, cross-border issues in the event of the future failure of a systemic international group would remain a challenge. Finally, the legislation leaves untouched the housing government-sponsored enterprises, where action is critically important given their weakened financial situation pending an ongoing review.

5. **Initial releases of second-quarter earnings results have been disappointing and illustrate the balance sheet risks identified in the FSSA’s section on stress testing.** Trading income, the backbone of earnings in the preceding quarters, has dropped. Credit-impairment costs, while lower, are likely to remain elevated for some time to come. And regulatory reforms are widely expected to dampen shareholder returns, even if it is too early to gauge their ultimate impact on the financial services industry.
Box 1. Selected Highlights of the Dodd–Frank Act

Systemic risk:
- Voting members of the FSOC: There will be ten: the Treasury Secretary (Chairperson), the Fed Chairman, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation (FDIC), the Chairman of the National Credit Union Administration, the Chairman of the Securities and Exchange Commission (SEC), the Chairman of the Commodity Futures Trading Commission (CFTC), the Director of the Federal Housing Finance Agency, the Director of the new BCFP, and an independent member appointed by the President with insurance expertise.
- Powers of the FSOC: These will include recommending prudential norms to primary regulators; requiring, with a two-thirds majority including the affirmative vote of the Treasury Secretary, that a nonbank financial firm be designated systemically important for oversight by the Fed; and approving, with a two-thirds majority, the break-up of systemic companies if deemed by the Fed to pose a “grave threat” to financial stability. Other key powers include designating systemic financial market utilities and payment, clearing, and settlement activities (see below).

Regulatory architecture:
- Number of agencies: The Office of Thrift Supervision will be abolished, but four new regulatory bodies will be set up (the FSOC, an Office of Financial Research, the BCFP, and a Federal Insurance Office).
- Bank supervision: The Fed will regulate and supervise BHCs, savings and loan holding companies (SLHCs), and state Fed-member banks; the Office of the Comptroller of the Currency will oversee national banks and federal thrifts; and the FDIC will oversee state nonmember banks and state thrifts. Charter conversions will require prior supervisory consent.
- Consumer financial protection: The BCFP will be established as an independent agency housed within the Fed’s Board of Governors; assume most consumer protection functions exercised by regulators under applicable federal laws; and have exclusive rule making and examination and primary enforcement powers over federally insured depositories with assets of $10 billion or more.
- Federal insurance oversight: The Federal Insurance Office will be located at the Treasury and will be responsible for gathering information, monitoring the insurance industry, making recommendations to the FSOC on insurers to be designated systemically important, and representing the United States on international insurance regulatory issues.

Micro-prudential regulation and supervision:
- Consolidated regulation and supervision: BHCs and SLHCs will be required to serve as sources of strength for their depository subsidiaries, and will be subject to capital requirements at least as high as on those subsidiaries; also, the Fed will enjoy expanded authority to examine all subsidiaries. New risk-based prudential norms will be issued for banks, BHCs, and designated nonbank financial firms; along with the latter, BHCs with group assets of $50 billion or more will automatically be subject to enhanced prudential standards. Studies will be conducted on limiting the use of hybrid capital instruments in tier 1 capital and strengthening capital floors for foreign-owned BHCs.
- “Volcker rule” activity restrictions: Banks and BHCs (but initially not systemic nonbank financial firms) will be proscribed from proprietary trading and investing in or sponsoring hedge or private equity and hedge funds, albeit with complex exceptions, transition arrangements, and various forthcoming studies by the FSOC and the GAO.

Infrastructure oversight:
- Systemic utilities: Designated utilities will be subject to heightened and uniform risk management standards; the Fed may grant utilities not chartered as banks access to Fedwire and, in unusual and exigent circumstances and after consulting the Treasury Secretary, access to the discount window.
Box 1 (concluded). Selected Highlights of the Dodd–Frank Act

Shadow banking sector:

- **Interest on demand deposits**: Banks and thrifts will be permitted to pay interest on demand deposits, improving their competitiveness vis-à-vis money market mutual funds.

- **Hedge/private equity fund registration**: Hedge fund and private equity fund advisors will be required to register with the SEC, which will be authorized to require information on trades and portfolios. Conversely, the assets-under-management threshold for federal regulation of investment advisers will be raised from $30 million to $100 million.

Securities and derivative market oversight:

- **“Skin in the game”**: Originators of asset- and mortgage-backed securities will be subject to a 5 percent risk retention requirement, although there will be exemptions for securities backed by “qualified residential mortgages” and government-guaranteed loans. Structured products will face stronger disclosure requirements on pooling arrangements and on the quality of underlying assets.

- **Regulation of derivatives**: The SEC and CFTC will regulate most swaps, which will be required to clear through central counterparties and trade on exchanges as possible. Trade data will be collected for surveillance purposes, and disseminated, and new capital and margin requirements will be imposed on dealers and major swap participants.

- **Swaps “push-out”**: Banks will be allowed to use swaps to hedge risk or trade in standardized interest rate and foreign exchange swaps. Other derivative trades will have to be spun off to separately capitalized affiliates within two years.

Crisis management, resolution, and systemic liquidity arrangements:

- **Special resolution mechanism**: In the event of a finding of unacceptable systemic risk by two-thirds of the Fed and FDIC Boards with written concurrence by the Treasury Secretary (after consulting with the President), and subject to appellate judicial review, the FDIC will be able to intervene any failing financial company not already subject to a carve-out from the U.S. Bankruptcy Code. Public funds will be available up-front, with unrecovered excess liquidation costs recouped through ex post assessments on large financial companies (with assets of $50 billion or more).

- **“Living wills”**: Identified systemic nonbank financial firms and large interconnected BHCs (the latter to be defined by the Fed, but including all BHCs with assets of $50 billion or more) will be required to submit rapid and orderly resolution plans to the FDIC, Fed, and FSOC. If the plans are found deficient by the FDIC and Fed, higher capital requirements will be imposed, with mandatory divestitures as the final sanction.

- **Deposit insurance**: Deposit insurance limits are raised permanently to $250,000. The minimum reserve ratio for the Deposit Insurance Fund is also to be increased, by 20 basis points, to 1.35 percent by 2020, with the assessment base moving from insured deposits to assets less equity.

- **Fed lending to nonbanks**: The Fed will be proscribed from lending to individual failing nonbank entities, with broadly available programs subject to ex ante approval by the Treasury Secretary and ex post reporting to Congressional committees and GAO review. The Fed, in consultation with the Treasury Secretary, must issue regulations guiding any future “unusual and exigent” lending.

- **FDIC guarantees**: These will be limited to broadly available guarantees of obligations of solvent banks, thrifts, BHCs, and SLHCs, after a joint determination by the Fed, FDIC, and Treasury Secretary (in consultation with the President) that a “liquidity event” exists. Maximum amounts will be recommended by the Treasury Secretary to the President and transmitted to Congress for expedited approval. The FDIC, in consultation with the Treasury Secretary, will issue regulations.