

ALERTS AND UPDATES

U.S. Financial Reform: Modifications to the U.S. Federal Reserve's Emergency Lending Authority

August 24, 2010

The *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* ("the Act") begins sweeping reform for the U.S. financial system. It requires new and existing regulatory agencies to undertake more than 50 studies of the financial system and more than 250 instances of rulemaking. Duane Morris has issued further Alerts on many of the broad topics addressed by the Act, accessible at www.duanemorris.com/FinancialReform.

Among other things, the Act amends section 13(3) of the Federal Reserve Act, relating to the U.S. Federal Reserve's emergency lending authority, and requires a one-time audit of the Federal Reserve's loans and financial assistance provided during the period from December 1, 2007, through the date of enactment of the Act. Many of the specifics of the Act will be set forth in policies and procedures that will be designed and implemented by administrative agencies, and are not set forth in the Act itself. The summary below highlights the key elements of this portion of the Act:

- **Limit of Lending Authority.** Section 13(3) of the Federal Reserve Act previously provided assistance to any "individual, partnership, or corporation," but now provides assistance to a "participant in any program or facility with broad-based eligibility," with the intent of preventing assistance that inappropriately favors one or more specific participants over other institutions.
- **Overview.** The Board of Governors of the Federal Reserve System (the "Board") is required to establish by regulation, in consultation with the Secretary of the Treasury, policies and procedures designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system – and not to aid a failing financial institution. Such policies and procedures are also required to ensure that the security for repayment of any emergency loan is adequate to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion.
 - Policies and procedures will require that a Federal Reserve Bank assign value to all collateral for a loan executed by a Federal Reserve Bank under an emergency lending program.
 - The Board is required to establish procedures to prohibit borrowing from programs and facilities by a borrower that is insolvent (such as a certification from the chief executive officer of the borrower that the borrower is solvent).
 - The Federal Reserve will no longer be able to lend to individual companies outside a program or facility with broad-based eligibility, such as its historical loans to Bear Stearns, AIG and Citigroup.
- **Approval of the Secretary of the Treasury.** Programs or facilities established under the Federal Reserve's emergency lending authority will require the prior approval of the Secretary of the Treasury and may not exist indefinitely.
- **Board Report.** Within seven days after the Board authorizes any loan or other financial assistance under its emergency lending authority under section 13(3) of the Federal Reserve Act, the Board is required to provide a report to the U.S. Senate and House of Representatives containing: (i) the justification for such assistance; (ii) the date and amount of the assistance; (iii) the form in which such assistance was provided; and (iv) the material terms of such assistance. The Chairman of the Board may request that the identity of the participants, the amounts borrowed by each participant and the identifying details concerning the assets or collateral in connection with such program or facility be kept confidential, in which case such information shall be made available to the chairpersons

or ranking members of the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

- **U.S. Government Accountability Office (GAO) Review.** The Comptroller General may conduct reviews of the Board, a Federal Reserve Bank or a credit facility for the purpose of assessing the following with respect to a credit facility or a covered transaction: (i) its operational integrity, accounting, financial reporting and internal controls; (ii) the effectiveness of the credit facility's or covered transaction's security and collateral policies in mitigating risk to taxpayers; (iii) whether the credit facility or the conduct of a covered transaction favors one or more specific participants over other institutions; and (iv) policies governing the use, selection or payment of third-party contractors. The Comptroller General is required to submit a report to Congress within 90 days after the date such review is completed. The Comptroller General is required to release a nonredacted version of the report on a credit facility one year after the effective date of the termination – a credit facility will be deemed to have terminated 24 months after the date on which the credit facility ceases to make extensions of credit – by the Board of the authorization of the credit facility or two years after the calendar quarter in which a covered transaction was conducted. Release of a nonredacted version of a report by the Comptroller General regarding covered transactions must occur upon the release of the information by the Board.

Public Access to Information

- **General.** The Board is required to publish on its website (i) reports prepared by the Comptroller General; (ii) annual financial statements prepared by an independent auditor of the Board; (iii) section 13(3) reports to the Committee on Banking, Housing, and Urban Affairs of the Senate; and (iv) other information the Board believes might assist the public in understanding the accounting, financial reporting and internal controls of the Board and the Federal Reserve Banks.
- **Transparency – Release of Information.** The Board is required to disclose certain information, including counterparties and information about amounts, terms and conditions of emergency credit facilities; discount window lending programs; and open market operations authorized or conducted by the Board or a Federal Reserve Bank on an ongoing basis, with specified time delays. The Board is required to disclose such information on the date that is one year after the effective date of the termination by the Board of the authorization of the credit facility.

Emergency Financial Stabilization

- **General.** The FDIC is required to create a widely available program to guarantee obligations of solvent insured depository institutions and solvent depository institution holding companies during times of severe economic distress, except that a guarantee of obligations under this section may not include providing equity in any form.
- **Policies and Procedures.** The FDIC is required to establish by regulation, in consultation with the Secretary of the Treasury, policies and procedures governing the issuance of deposit guarantees. The terms and conditions of any guarantee program are required to be established by the FDIC, with the concurrence of the Secretary of Treasury. The use of a guarantee program requires a determination by both the FDIC (upon a vote of no fewer than two-thirds of the members of the FDIC then serving) and the Board (upon a vote of no fewer than two-thirds of the members of the Board then serving) that "(i) a liquidity event exists; (ii) failure to take action would have serious adverse effects on the financial stability or economic conditions in the United States; and (iii) actions authorized under section 1105 are needed to avoid or mitigate potential adverse effects on the United States financial system

or economic conditions." The Secretary of the Treasury is required to determine the maximum amount of the guarantee, in consultation with the President of the United States, to be approved by the joint resolution of Congress. Requests for resolutions of authority are to be considered by Congress in an expedited manner. The Act provides that if a request is received by the Senate while it is adjourned or recessed for more than two days, the Senate is required to convene no later than the second calendar day after receipt. Congress is required to move to proceed to the consideration of the joint resolution between the fourth and seventh day after Congress receives the request.

- **Funding.** The FDIC is required to charge fees and other assessments to all participants in the guarantee programs in the amounts necessary to offset projected losses and administrative expenses, and may also borrow funds from the Secretary of the Treasury for purposes of carrying out the guarantee program. The FDIC may also impose a special assessment solely on participants to address any insufficiency in the funding of the guarantee program for which the Act provides authority. The FDIC may not borrow from the Deposit Insurance Fund.
- **Parallel Federal Deposit Insurance Act Authority.** Upon the enactment of the modifications to section 13(3) of the Federal Reserve Act, the FDIC may no longer exercise its authority under section 13(c)(4)(G)(i) of the Federal Deposit Insurance Act (12 U.S.C. 1823(c)(4)(G)(i)) to establish any widely available debt guarantee program for which such modifications would provide.

Federal Reserve Bank Governance

- **Election of Federal Reserve Presidents.** Presidents of the Federal Reserve Banks will from now on be elected by Class B directors (elected by member banks to represent the public) and Class C directors (appointed by the Board to represent the public) of the member banks, with the approval of the Board. Prior to the Act, presidents of the Federal Reserve Banks were elected by all directors, including Class A directors (elected by member banks to represent member banks).

Establishment of the Position of Vice Chairman

- **Creation of Position of Vice Chairman for Supervision.** The Act creates a new position of Vice Chairman for Supervision ("Vice Chairman"), a person designated by the President of the United States by and with the advice and consent of the Senate. The Vice Chairman is charged with developing policy recommendations for the Board regarding the supervision and regulation of depository institution holding companies and other financial firms supervised by the Board to ensure oversight accountability. The Vice Chairman is required to report to Congress at semiannual hearings regarding Board's the efforts, activities, objectives and plans.

GAO Audit of the Federal Reserve Facilities

- **Audit of the Federal Reserve.** The Comptroller General is required to conduct a one-time audit of all loans and other financial assistance provided by the Board or a Federal Reserve Bank and any other program created as a result of any emergency lending authority under section 13(3) of the Federal Reserve Act during the period beginning on December 1, 2007, and ending on the date of enactment of the Act. The audit must commence no later than 30 days after the date of enactment of the Act and is required to be completed no later than 12 months after the enactment of the Act. The Board is required to publish on its website, not later than December 1, 2010, the amounts, terms and conditions of the emergency lending assistance provided.

- **Audit of Federal Reserve Governance.** Not later than one year after the date of enactment of the Act, the Comptroller General is required to complete an audit of the governance of the Federal Reserve Bank system, including a study of the current system for appointing Federal Reserve Bank directors, and examine whether actual or potential conflicts of interest exist. The Comptroller General is required to also examine the establishment and operation of emergency lending facilities. The report on the audit is required to be submitted by the Comptroller General to Congress before the end of the 90-day period, beginning on the date on which such audit is completed.

About Duane Morris

Duane Morris has an online **Financial Services Reform Center** – www.duanemorris.com/FinancialReform – which includes videos and the firm's comprehensive series of *Alerts* analyzing the provisions of the Act and emerging policies, as well as links to relevant government websites. Duane Morris' attorneys will be monitoring the rules and regulations released under the Act, as well as the regulatory agencies' interpretive guidance. For [subsequent Alerts](#) on these and other topics, please revisit www.duanemorris.com and www.duanemorris.com/FinancialReform.

For Further Information

If you have any questions about the Act or any of the topics described in this *Alert*, including how they may affect your company or its executives, please contact [Joel N. Ephross](#), [T. John Lin](#), any [member](#) of the [Corporate Practice Group](#) or the attorney in the firm with whom you are most regularly in contact.

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