Providing The Government With Tools To Effectively Manage Financial Crises

Over the past two years, the financial system has been threatened by the failure or near failure of some of the largest and most interconnected financial firms. The federal government's ability to deal with these events was severely complicated by the lack of a statutory framework for avoiding the disorderly failure of a nonbank financial firm. Emergency access to the Fed's balance sheet is no substitute for a well-crafted resolution authority. Accordingly, the Administration's plan establishes a resolution authority for the largest and most interconnected firms to help ensure that the federal government does not, in the future, have to choose between bailouts and financial collapse. Combined with stronger capital and liquidity standards and additional preventative measures, this authority will help to contain future crises.

Reducing The Likelihood and Impact Of Failures

Impose More Stringent Capital, Activities, and Liquidity Requirements On Large, Interconnected Firms (Tier 1 FHCs):

- In view of the risks such firms introduce into the financial system, Tier 1 FHCs will be subject to more stringent capital, activities, and liquidity standards, and more exacting prudential supervision.

Require Prompt Corrective Action From Large, Interconnected Firms Should Their Capital Levels Decline:

- Tier 1 FHCs will be subject to a prompt corrective action regime that would require the firm and its supervisor to take corrective actions as the firm's regulatory capital levels decline.
- This regime will mirror the prompt corrective action regime for insured depository institutions established under the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

Planning In Advance For Orderly Resolution

Require Rapid Resolution Plans From All Large, Interconnected Firms:

- The Federal Reserve will require each Tier 1 FHC to prepare and continuously update a credible plan for the rapid resolution of the firm in the event of severe financial distress.

Providing A Regulatory Regime That Can Adequately Respond To A Financial Crisis

Provide The Government With Emergency Authority To Resolve Any Large, Interconnected Firm In An Orderly Manner:

- The Administration's plan gives the federal government the authority necessary to avoid the disorderly resolution of large, interconnected firms when the stability of the financial system is threatened.
- The proposed resolution authority would supplement (rather than replace) and be modeled on the existing resolution regime for insured depository institutions under the Federal Deposit Insurance Act.
- Under the Administration's plan, the Treasury Department can invoke the resolution authority only after consulting with the President and upon the written recommendation of two-thirds of the members of the Federal Reserve Board, and the FDIC or SEC as appropriate.

- To invoke this authority, the Treasury Department must make the following determinations:
    1. That the firm is in default or in danger of defaulting
    2. That the failure of the firm would have serious adverse effects on the financial system
    3. That the use of the special resolution authority would avoid or mitigate these adverse effects

- The resolution authority will give Treasury the ability to appoint a receiver or conservator for the failing firm. In general, that role will be played by the FDIC though the SEC may be appointed in certain cases.

- The conservator or receiver of the firm will have a broad set of powers including authority to take control of the operations of the firm, sell or transfer all or any parts of the firm’s assets. The resolution authority will also include the ability to provide loans, assume liabilities, or inject capital.