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SECURITIES INDUSTRY

ALERT

THE FRR REPORT PROPOSES A RESOLUTION REGIME TO AID FAILING FIRMS

On June 17, 2009, the U.S. Department of the Treasury (Treasury) released a five-part report titled "*Financial Regulatory Reform A New Foundation: Rebuilding Financial Supervision and Regulation*" (FRR Report). The FRR Report, as well as a speech by President Obama, outlined a proposal designed to amend supervision and regulation within the financial system, including, among other things, focusing on creating tools that will assist the Treasury in aiding failing firms during future financial crises.

The current financial system only provides two resolution mechanisms for an interconnected bank holding company (BHC) or another non-bank financial firm nearing failure during a financial crisis. These mechanisms include: (1) obtaining emergency funding from the federal government (like AIG); or (2) a bankruptcy filing (like Lehman Brothers). If the proposals are enacted, the Treasury authority would be expanded to aid failing firms under the current framework by proposing the creation of a "resolution regime." The "resolution regime" will not replace bankruptcy in the normal course of business but rather will empower the Treasury with the authority to determine how to orderly sustain a failing BHC or non-bank firm. However, the Treasury's augmented powers will only arise if a "systemic risk exception" is triggered and after consultation with the President.

A "systemic risk exception" would be activated if a firm's failure would pose a severe risk to the entire financial system. The exception would permit the "resolution regime" to take any action justified, not only cost-effective alternatives, including, among other things, establishing a conservatorship or receivership for a failing firm, providing loans to a failing firm or BHC, purchasing assets from a failing firm, guaranteeing the liabilities of a failing firm or BHC or making equity investments in a failing entity. Although the authority to decide whether to resolve the failing firm will reside with the Treasury, the Federal Reserve Board (FRB), FDIC and even the SEC may initiate the process.

In addition to the "resolution regime," the FRR Report also recommends that the Treasury be provided with the authority to oversee the FRB's ability to extend emergency funding. It is proposed that Section 13(3) of the Federal Reserve Act be amended to require the Treasury Secretary's prior written approval before the FRB provides any credit extensions to individuals, partnerships or corporations in "unusual and exigent circumstances." This proposal will broadly extend the Treasury's supervisory authority over the FRB.

The FRR Report's proposals will produce vast changes to the supervision and regulation of the financial system. Significantly, the creation of a "regulatory regime" may severely impact the level of self-control struggling BHCs and non-bank firms would possess during future financial crises. Fox Rothschild LLP attorneys will continue to monitor the situation and report when necessary.

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