

Dodd-Frank Act: enhanced prudential supervision for systemic risk

Enhanced prudential supervision for systemic risk is a key outcome of the Dodd-Frank Act. Regulation is defined for systemically important bank holding companies (those with assets in excess of \$50bn) and systemically important nonbank finance companies (criteria to be defined) in order to address risk to the financial stability of the US posed by this category of institutions.

The regulation includes:

- » Inclusion of off-balance sheet activities in computing capital requirements
- » Limits on credit exposure to non-affiliates - the regulation prohibits credit exposure to any unaffiliated company that exceeds 25% of the capital stock. Reports must be submitted to the Fed, Council and FDIC detailing credit exposure to other "significant" nonbank financial companies and "significant" bank holding companies
- » Living wills (resolution plans) including details of ownership structure, assets, liabilities, contractual obligations, affiliates and counterparties
- » Significant counter-party credit exposure reports
- » Enhanced public disclosures
- » Short-term debt limits
- » Annual stress testing by Federal Reserve and semi-annual internal stress testing. In addition institutions with assets in excess of \$10bn must conduct internal annual stress tests
- » Risk committees must be established for bank holding companies with assets in excess of \$10bn
- » Early Remediation – remedial actions can be taken by the Fed if a company is in financial distress. These will increase in strength if the company's financial condition deteriorates. They are intended to minimize the possibility insolvency.

Financial institutions impacted by this law

- » Banks and bank holding companies with assets over \$50bn and systemically important nonbank finance companies
- » For risk committees, bank holding companies with assets over \$10bn
- » For stress testing, banks and bank holding companies with assets over \$10bn and nonbank finance companies with assets over \$10bn