NOTHING BUT THE FACTS: THE GLASS-STEAGALL ACT

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This statement by the Committee on Capital Markets Regulation provides important factual details about the Glass-Steagall Act and the Gramm-Leach-Bliley Act ("the **GLBA**").

The Glass-Steagall Act is a Depression era law that separated certain commercial banks (Federal Reserve member banks in the business of accepting customer deposits and extending loans referred to herein as **"commercial banks"**) from firms engaged in securities activities (firms in the business of trading securities for customers and helping companies raise capital, often referred to as **"investment banks"**). In 1999, the Glass-Steagall Act was partially repealed by the GLBA.

More recently, in July 2016, the Republican Party platform stated support for reinstating the Glass-Steagall Act.[1] In February 2017, Representative Kaptur and several other co-sponsors introduced H.R. 790, modeled after the Glass-Steagall Act.[2] And in April 2017 Senators Warren, McCain, Cantwell and King proposed bipartisan legislation to reinstate a modern version of the 1933 law.[3] Most recently, at a May 2017 Senate Banking Committee hearing, Secretary Mnuchin clarified that the Trump Administration may support a "21st Century" version of the Glass-Steagall Act, although the Administration does *not* support a full separation of commercial and investment banking.[4]

Part I of this statement explains that the Glass-Steagall Act prohibited commercial banks from directly engaging in certain securities activities. It also prohibited firms engaged in certain securities activities from accepting deposits. It further established restrictions on the *affiliation* of commercial banks with firms engaged in securities activities. We conclude this section by explaining the reasons for the adoption of the Glass-Steagall Act.

Part II of this statement explains that the GLBA *partially* repealed the Glass-Steagall Act by allowing commercial banks to affiliate with firms engaged in certain securities activities. However, Glass-Steagall's prohibitions on commercial banks directly engaging in certain securities activities remain in effect today. We then explain the reasons for the adoption of the GLBA and describe the existing legislative and regulatory requirements that mitigate the transfer of risk between commercial banks and their affiliates.

Part III of this statement describes Dodd-Frank's "Hotel California" provision that designates successor entities of certain bank holding companies (potentially including securities affiliates), as non-bank systemically important financial institutions ("**SIFIs**") subject to enhanced regulatory scrutiny.[5] The potential designation of successor entities as non-bank SIFIs may be discouraging bank holding companies from voluntarily spinning off certain securities affiliates.

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[1] REPUBLICAN NATIONAL COMMITTEE, REPUBLICAN PLATFORM 2016 28 (2016), https://prod-cdn-static.gop.com/media/documents/DRAFT_12_FINAL[1]-ben_1468872234.pdf.

[2] Return to Prudent Banking Act of 2017, H.R. 790, 115th Cong. (2017)

[3] Press Release, Elizabeth Warren, Senators Warren, McCain, Cantwell and King Introduce 21st Century Glass-Steagall Act (Apr. 6, 2017), https://www.warren.senate.gov/?p=press_release&id=1533.

[4] CNBC, *Elizabeth Warren and Treasury Secretary Steve Mnuchin Spar Over Glass-Steagall* (May 18, 2017), http://video.cnbc.com/gallery/?video=3000619795.

[5] This statement should not be taken as Committee support for eliminating the Hotel California provision.

I. The Glass-Steagall Act

The Glass-Steagall Act was adopted as part of the Banking Act of 1933[6] following a wave of over 9,000 Depression-era bank failures from 1930-1933.[7] It refers to four sections of the Banking Act of 1933 (Sections 16, 20, 21 and 32).[8] These four sections operated together to (i) restrict commercial banks from engaging in or being affiliated with firms engaged in investment banking-like activities,[9] defined as the "issue, floatation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation" of securities,[10] which we will refer to throughout this statement as "**securities activities**" and (ii) restrict the ability of firms engaged in securities activities from accepting deposits.[11]

It is important to note, however, that because the Glass-Steagall affiliation restrictions only covered Federal Reserve System member banks, non-member depository institutions like *thrifts* and state-chartered banks[12] *could* affiliate with firms engaged in securities activities. For example, the retailer Sears owned both a thrift, Sears Savings Bank, and a securities firm, Dean Witter Reynolds.[13]

Activity Restrictions – Sections 16 and 21

Section 16, which remains in place today, limited commercial banks to "*the business of banking*," and "all such incidental powers . . . necessary to carry on the business of banking," defined by the statute to include receiving deposits; buying, selling and exchanging coins and bullion; and making secured and unsecured loans.[14]

Section 16 expressly forbade a commercial bank itself from engaging in securities activities, including acting as an underwriter in securities offerings or from trading securities for its own account.[15] However, Section 16's language made clear that commercial banks can trade securities for a customer's account upon an order from a customer[16] and a commercial bank can underwrite, deal and purchase obligations of the federal government, states and their political subdivisions (i.e., cities and towns) and federal agencies.[17]

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[6] Pub L. No. 73-66, 48 Stat. 162 (1933).
[7] Oonagh McDonald, Policy Analysis No. 804, *The Repeal of Glass-Steagall: Myth and Reality*, CATO INSTITUTE (Nov. 16, 2016), https://www.cato.org/publications/policy-analysis/repeal-glass-steagall-act-myth-reality.
[8] DAVID H. CARPENTER, ET AL., CONG, RESEARCH SERV., THE GLASS-STEAGALL ACT: A LEGAL AND POLICY ANALYSIS 1 (2016), https://fas.org/sgp/crs/misc/R44349.pdf.
[9] *Id.*; McDonald, *supra* note 7. Indeed, after adoption of the law, J.P. Morgan & Co., which had been a financial conglomerate, split into two firms – Morgan Stanley, the investment bank, and JPMorgan, a commercial bank. Carpenter et al., *supra* note 8, at 7.
[10] Banking Act of 1933, Pub L. No. 73-66, § 20, 48 Stat. 162 (1933).
[11] *Id.* § 21.
[12] Nationally-chartered banks are required to be members of the Federal Reserve System. 12 U.S.C. § 222.
[13] COMM. ON CAP. MKTS. REG., THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM 193 (2009).
[14] Banking Act of 1933, Pub L. No. 73-66, §§ 5, 16, 48 Stat. 162 (1933).
[15] *Id.* § 16.
[16] *Id.*
[17] *Id.*

Interpretations of Section 16 of the Glass-Steagall Act by the Office of the Comptroller of the Currency ("**OCC**"), largely during the 1980s, clarified that a number of activities could be permitted within the meaning of the "business of banking." Through a series of interpretative letters, the OCC permitted commercial banks and their subsidiaries to become members of security[18] and commodity exchanges[19]; and engage in activities including discount brokerage,[20] investment company advising,[21] securities lending,[22] individual retirement account management,[23] private placement of securities,[24] and underwriting, dealing and holding general obligation municipal bonds.[25] In 1995, the Supreme Court upheld the OCC's interpretations as valid readings of the Glass-Steagall Act.[26]

Importantly, in the late 1980s the OCC and the Second Circuit Court of Appeals held that the Glass-Steagall Act did not bar securitization of mortgages by commercial banks.[27] In addition, the plain language of Section 16 of the Glass-Steagall Act allowed commercial banks to own mortgage-backed securities issued or guaranteed by Fannie Mae or Freddie Mac.[28] In interpretative letters from 1999 and 2005, respectively, the OCC provided interpretations permitting (i) the purchase of investment grade loan-backed securities even if not issued or guaranteed by Fannie Mae or Freddie Mac and (ii) the retention of interests in a securitization of a bank's own loans.[29]

In addition, Section 21 prevented any person or firm engaged in securities activities from engaging "in the business of receiving deposits."[30] It remains in place today.

Affiliation Restrictions – Sections 20 and 32

Section 20 of the Glass-Steagall Act built upon the ban on direct involvement in securities activities by commercial banks. It did so by outlawing indirect involvement through affiliates. Specifically, Section 20 prohibited commercial banks (which included all the larger banks in 1933) from controlling, being controlled by or being under common control with firms "engaged principally" in securities activities – specifically, the issuance, public sale,

[18] Office of Comptroller of the Currency, Interpretive Letter No. 380 (Dec. 29, 1986).
[19] *Id.* (citing J.T. Watson, Deputy Comptroller of Currency (July 11, 1975) (unpublished letter)).
[20] Sec. *Indus. Ass'n. v. Comptroller of Currency*, 577 F. Supp. 252 (D.D.C. 1985).
[21] Office of Comptroller of the Currency Interpretive Letter No. 386 (June 10, 1987).
[22] Interpretive Letter No. 380, *supra* note 18.
[23] *Inv.. Co. Inst. v. Clarke*, 630 F. Supp. 593 (D. Conn. 1986).
[24] 73 Fed. Reserve Bulletin 2, n.43 (1987) (citing OCC guidance permitting private placements).
[25] Carpenter et al., *supra* note 8, at 13.
[26] *NationsBank of N.C. v. Variable Annuity Life Insurance Co. (VALIC)*, 513 U.S. 251, 258 n.2 (1995) ("We expressly hold that the 'business of banking' is not limited to the enumerated powers in §24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.").
[27] *Sec. Indus. Ass'n v. Clarke*, 885 F.2d 1034 (2d Cir. 1989), cert. denied, 110 S. Ct. 1113 (1990) (permitting securitization under Glass-Steagall § 16); Letter from Robert L. Clarke to Russell A. Freeman, Office of Comptroller of the Currency, Letter No. 388 (June 16, 1987) (stating that pooling loans and selling them is a permitted activity of a commercial bank).
[28] 12 U.S.C. § 24 (Seventh).
[29] *See, e.g.*, 12 C.F.R. §§ 1.2(l) - (n), 1.3(c) - (h); Letter from Tena Alexander, Senior Attorney, OCC, dated August 3, 1999 (ownership of collateralized bond obligation securities); OCC Interpretive Letter No. 1035 (July 21, 2005) (securitization of and ownership of securities in securitization of, own home equity lines of credit).
[30] Banking Act of 1933, Pub L. No. 73-66, § 21, 48 Stat. 162 (1933).

underwriting or distribution of bonds, stocks and other securities.[31] This restriction included prohibiting a commercial bank affiliate from dealing in securities for its own account.[32]

The extent of the affiliation restrictions imposed by Section 20 was clarified gradually over time by the Federal Reserve, which permitted increasing affiliations between commercial banks covered by Glass-Steagall and firms engaged in securities activities. From 1933 to 1984, there were no attempts by bank organizations to test what it meant for an affiliate to be "principally engaged" in securities activities.[33] In 1984, Citicorp filed an application seeking permission to have a subsidiary engage in securities activities so long as revenue from the otherwise prohibited securities activities did not exceed 20% of the subsidiaries revenue.[34] However, Citicorp withdrew its application.[35]

In 1987, in response to applications by several banking firms, the Federal Reserve clarified the extent of the limitation on a commercial bank's affiliation with a firm "principally engaged" in such activities and expressly allowed bank holding companies that owned commercial banks to engage in securities activities through affiliates that became known as "**Section 20 subsidiaries**" so long as revenues derived from those activities did not exceed five to ten percent of the subsidiary's revenue.[36] Specifically, the Federal Reserve allowed these Section 20 subsidiaries to underwrite and deal in commercial paper, municipal revenue bonds, and mortgage-backed securities and in 1989 allowed Section 20 subsidiaries to underwrite and deal in corporate debt and equity as well.[37] In 1996, the Federal Reserve increased this threshold to 25%.[38] At least 41 Section 20 subsidiaries had been approved by the Federal Reserve at the time of the passage of the GLBA in 1999.[39]

The final section of the Glass-Steagall Act, Section 32, prohibited overlapping board membership and management of commercial banks and firms engaged in securities activities.[40]

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[31] Banking Act of 1933, § 20. The Banking Act of 1933 defines an affiliate as an entity that the commercial bank controls or with which it is under common control. *Id.* § 2(b).
[32] Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Fed. Reg. 68750, 68751 (Dec. 30, 1996) (noting that Section 20's prohibitions covered both underwriting and dealing). *Sec. Indus. Ass'n v. Bd. of Governors of the Fed. Reserve Sys.*, 468 U.S. 207, 219 n.20 (1984) (stating that Section 20 prohibited bank affiliates from the activities of dealing in, underwriting and purchasing for its own account investment securities).
[33] H. Rodgin Cohen, *Section 20 Affiliates of Bank Holding Companies*, 1 N.C. BANK. INST. 113, 114 (1997), http://scholarship.law.unc.edu/cgi/viewcontent.cgi?article=1011&context=ncbi.
[34] *Id.*
[35] *Id.*
[36] *Sec. Indus. Ass'n. v. Board of Governors*, 839 F.2d 47, 51 (2d Cir. 1988).
[37] Cohen, *supra* note 33, at 114-15; Y. Emilie Yoo, *Financial Regulation and Supervision Across Business Lines in the United States*, Institute for Monetary and Financial Stability Working Paper No. 76, at 15 (2013), https://www.econstor.eu/bitstream/10419/97784/1/IMFS_WP_76.pdf.
[38] 61 Fed. Reg. 68,750 (Dec. 30, 1996).
[39] Carpenter et al., *supra* note 8, at 14 (citing 61 Fed. Reg. 68,751 (Dec. 30, 1996)).
[40] Banking Act of 1933, § 32.

Reasons for Adoption of Glass-Steagall

The Supreme Court's 1971 decision in *Investment Company Institute v. Camp* offers a detailed analysis of the legislative history of Glass-Steagall and indicates that the danger that a commercial bank might fail because of its own or an affiliate's poor execution of securities activities was not the major reason behind the legislation.[41] Instead, it was fear that relationships between commercial banks and firms engaged in securities activities could pose "conflicts of interest."[42]

The Supreme Court stated that Congress identified at least three potential conflicts of interest. First, that a commercial bank might make an unsound loan to an affiliated firm engaged in securities activities if that affiliate were to fare poorly.[43] Second, that a commercial bank might make credit more freely available to customers of its affiliate engaged in securities activities or to companies in whom its affiliate owned securities.[44] Third, that a commercial bank would use depositors to unload securities being sold by the affiliated firm engaged in securities activities.[45]

The Supreme Court's opinion did note that one danger that concerned Congress was the risk that the solvency of a commercial bank could be threatened by poor investment decisions by an affiliate engaged in securities activities.[46] However, the Court observed that because affiliates engaged in securities activities are legally separate entities from commercial banks, their solvency problems would not directly put at risk the commercial bank's capital.[47]

It is notable that from 1930 to 1933, 26% of all nationally-chartered banks failed, whereas only 6.5% of banks with securities affiliates failed and 7.6% of banks with large bond operations failed.[48]

[41] 401 U.S. 617, 630-34 (1971).
[42] *Id.* at 629 (citing *Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Sen. Comm. on Banking and Currency*, 71st Cong. 40 (1931)); Carpenter, et al, *supra* note 8, at 3 (citing SEN. COMM. ON BANKING AND CURRENCY PURSUANT TO S. RES. 84, 72D CONG., *Stock Exchange Practices*, 113-14, 155-56).
[43] *Camp*, 401 U.S. at 631.
[44] *Id.*
[45] *Camp*, 401 U.S. at 633. The Court also stated that Congress was concerned that if bank depositors suffered losses on investments recommended to them by their bank, then the customers would lose confidence in the bank and withdraw their deposits. *Id.* at 632.
[46] *Id.* at 630.
[47] *Id.*
[48] McDonald, *supra* note 7.

II. The Gramm-Leach-Bliley Act

In 1999, the Gramm-Leach-Bliley Act (**"GLBA"**) passed Congress with 90 votes in the Senate[49] and 362 votes in the House[50] receiving majority support from both the Republican and Democratic caucuses. It was signed into law by President Clinton in November 1999.[51]

The GLBA repealed Sections 20 and 32 of Glass-Steagall.[52] As a reminder, Section 20 prohibited a commercial bank from affiliating with a firm engaged in securities activities and Section 32 prohibited interlocking management and boards of directors between such a commercial bank and firms engaged in securities activities. In addition, the GLBA detailed the types of "financial activities" that the affiliates of commercial banks could conduct. These "financial activities" are securities activities,[53] insurance underwriting and acting as an insurance agent,[54] providing investment, financial, or economic advisory services, merchant banking, and any activity determined by the Federal Reserve Board by regulation or order to be financial in nature, incidental to financial activities, or complimentary to a financial activity that does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.[55]

Importantly, the GLBA did not repeal Sections 16 or 21 of Glass-Steagall, which prohibit a commercial bank from engaging in securities activities and prohibit firms engaged in securities activities from taking deposits.[56] The rationale behind keeping Section 16 and 21 of Glass-Steagall was to maintain a legal separateness between commercial banking entities

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[49] U.S. Senate, Roll Call Vote 106th Congress – 1st Session (Nov. 4, 1999), https://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=106&session=1&vote=00354

[50] S. 900 (106th): Gramm-Leach-Bliley Act (Nov. 4, 1999), https://www.govtrack.us/congress/votes/106-1999/h570.

[51] Pub. L. No. 106-102, 113 Stat. 1338 (1999) (*hereinafter* "GLBA"); William J. Clinton, Statement on Signing the Gramm-Leach-Bliley Act (Nov. 12, 1999).

[52] GLBA § 101 (repealing Sections 20 and 32 of Glass-Steagall).

[53] This basket of activities consists of lending, exchanging, transferring, and investing money or securities for others; safeguarding money or securities; issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; and underwriting, dealing in, or making a market in securities.

[54] This basket of activities consists of insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing.

[55] GLBA §§ 103, 121. Commercial banks can be affiliated with firms engaged in these activities in one of two ways. First, the commercial bank can be a subsidiary of a financial holding company and the holding company can engage in the financial activities permitted by the GLBA either at the holding company level or through a subsidiary separate from the commercial bank subsidiary. Second, the affiliated firm can be a subsidiary of a national bank. The scope of permissible activities of the affiliated firm are somewhat narrower if the second structure is used. Specifically, the subsidiary cannot engage in insurance activities, real estate development or real estate investment, or merchant banking. *Id.* § 121.

[56] C. Wallace DeWitt, *Reinforcing Glass-Steagall Won't Prevent Another Financial Crisis*, THE FEDERALIST, http://thefederalist.com/2016/01/25/reinforcing-glass-steagall-wont-prevent-another-financial-crisis/ (last visited May 24, 2017).

and affiliates engaged in securities activities so that losses from securities activities would not spread to the commercial bank.[57]

Reasons for Adoption of GLBA

Two important reasons why Congress adopted the GLBA were: (1) to increase competition in securities services; and (2) to increase the competitiveness of U.S. banks by placing them on an equal footing with global banks.

First, even though regulators had provided interpretations on some activities that may be permitted under Glass-Steagall, banks still had to deal with limitations imposed by the law and engage with regulators about what activities would be permitted or not. Thus, it still imposed barriers to commercial banks' affiliation with firms engaged in securities activities and vice versa. Such barriers raised concern that Glass-Steagall had resulted in industry concentration, particularly among underwriters. By reducing barriers to entry, Democratic Senator Proxmire argued that competition among firms engaged in securities activities would increase and drive down the cost of capital for corporations, governments and individuals.[58]

Second, foreign banks were not subject to restrictions similar to Glass-Steagall. In fact, a 1997 study indicated that out of the then 15 E.U. countries, plus Canada, Japan, Switzerland and the U.S., only Japan and the U.S. limited the financial activities of banking organizations[59] and Japan abolished its version of Glass-Steagall in 1994.[60] Supporters of the GLBA believed such barriers hurt U.S. bank competitiveness against foreign banks because U.S. commercial banks and U.S. investment banks were hindered from offering the same range of products and services to customers as foreign banking organizations could offer.[61] Thus, the GLBA placed U.S. banks on a more even playing field with foreign competitors.

Addressing Conflicts of Interest and the Transfer of Financial Risk Between Affiliates

Even after the partial repeal of the Glass-Steagall Act, potential conflicts of interest and the potential transfer of financial risk between affiliated commercial banks and firms engaged in securities activities remained highly regulated. That is because laws governing the interactions among affiliates were adopted contemporaneously with and after the passage of the Glass-Steagall Act and the GLBA itself also included further restrictions.

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[57] *See, e.g.*, Fred Furlong, Fed. Reserve Bank of San Francisco, Economic Letter 2000-10, *The Gramm-Leach-Bliley Act and Financial Integration* (2000), http://www.frbsf.org/economic-research/publications/economic-letter/2000/march/the-gramm-leach-bliley-act-and-financial-integration/; 1045 CONG. REC. H11,516 (daily ed. Nov. 4, 1999) (statement of Rep. Roukema).

[58] Statement of Senator Proxmire, S3,380.

[59] J Barth, D. Nolle & T. Rice, Office of Comptroller of Currency, Economics Working Paper No. 97-6, *Commercial Banking Structure, Regulation and Performance: An International Comparison* (1997).

[60] ROY C. SMITH & INGO WALTER, GLOBAL BANKING 174 (2003). Japan's equivalent of Glass-Steagall also allowed Japanese banks to invest in the stock of debtor commercial clients, unlike the U.S. law. *See* Marilyn B. Cane & David A. Barclay, *Competitive Inequality: American Banking in the International Arena*, 13 B.C. INT'L & COMP. L.J. 273, 298 (1990).

[61] Proxmire, *supra* note 58, at S. 3,382.

First, Sections 23A and 23B of the Federal Reserve Act heavily regulate the types of affiliated party transactions a related commercial bank and firm engaged in securities activities can conduct.[62] A version of Section 23A was first adopted in 1933[63] and amended numerous time before the passage of the GLBA in 1999.[64] Importantly, Section 23A imposes quantitative caps on the extent of transactions between affiliates, based on the bank's capital, thus limiting the economic relationship between the entities and reducing the chance that risk could spread from one entity to another. Section 23B, adopted in 1987,[65] requires that any affiliate party transaction be conducted on arm's-length, market terms.[66] Importantly, these provisions specifically prohibit a commercial bank from purchasing securities for itself or its fiduciary customers if an affiliated entity is acting as an underwriter of the security, subject to certain narrow exceptions.[67]

Second, in 1966 Congress amended the Federal Deposit Insurance Act of 1950 to allow banking regulators wide discretion to police potential conflicts of interest and ill-advised related-party transactions through their authority to sanction federally-insured commercial banks for unsafe and unsound banking practices.[68]

Finally, in 1970, as amendments to the Bank Holding Company Act of 1956[69] commercial banks were prohibited from extending credit, leasing or selling property or furnishing services to a customer on the condition that the customer obtain credit, property or services from an affiliated investment bank.[70] Such restrictions were known as anti-tying prohibitions.

The GLBA included provisions aimed at buttressing the restrictions noted above. First, the GLBA amended Sections 23A and 23B of the Federal Reserve Act to ensure that they would apply to certain newly permitted bank subsidiaries under the GLBA.[71] Second, the GLBA amended the anti-tying provisions in the Bank Holding Company Act so that they would cover the GLBA-permitted subsidiaries of national banks that engaged in securities activities.[72]

Most recently, the Dodd-Frank Act expanded Sections 23A and 23B of the Federal Reserve Act to cover more potential transactions between affiliates, such as derivative and securities financing transactions.[73]

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[62] 12 U.S.C. §§ 371c, 371c-1.
[63] 48 Stat. 183 (1933).
[64] *E.g.*, 49 Stat. 717 (1935); 68 Stat. 358 (1959); 73 Stat. 457 (1966); 80 Stat. 241 (1982); 96 Stat. 1515 (1983).
[65] Pub. L. 100-86, title I, § 102(a), 101 Stat. 564 (Aug. 10, 1987).
[66] 12 U.S.C. § 371c-1.
[67] *Id.* § 371c-1(b)(1)(B).
[68] 80 Stat. 1046. *E.g.*, 12 U.S.C. § 1818(b), (e), (i).
[69] 84 Stat. 1766.
[70] 12 U.S.C. §§ 1971, 1972.
[71] *See* 12 U.S.C. § 371c(e); 113 Stat. 1378-79.
[72] 113 Stat. 1380; 12 U.S.C. §§ 1971, 1972.
[73] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 608.

III. Dodd-Frank's "Hotel California"

Dodd-Frank has created some uncertainty about how successor entities to certain large banking holding companies would be regulated were they to be spun-off into independent firms. This may be discouraging certain large bank holding companies from voluntarily spinning off securities affiliates. We seek to provide clarity below.

Section 117 of Dodd-Frank (**"Hotel California Provision"**) applies to bank holding companies that: (a) had greater than $50 billion in assets as of January 1, 2010; and (b) received financial assistance from the Troubled Asset Relief Program ("**covered bank holding companies"**). Section 117 also applies to any successor entity (as defined by the Federal Reserve) of a covered bank holding company,[74] which may include a large securities affiliate. Based on our estimates, covered bank holding companies presently hold approximately 60% of U.S. banking assets.

If a successor entity ceases to be a bank holding company then the Hotel California Provision provides that such a successor entity be treated as a non-bank systemically important financial institution ("**non-bank SIFI**").[75] Dodd-Frank subjects non-bank SIFIs to the living wills process,[76] certain aspects of the Volcker Rule, heightened minimum capital and liquidity requirements,[77] and Federal Reserve examinations.[78] The Hotel California Provision provides an appeal process for entities designated as non-bank SIFIs by this Provision.

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Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), its Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org), or Senior Fellow, Brent Speed (bspeed@capmktsreg.org) at your convenience.

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[74] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 117.This provision is referred to as the "Hotel California" provision because it was intended to ensure that large financial institutions that converted to bank holding companies during the crisis would remain subject to Federal Reserve supervision even if they tried to revert back to their old form. Shearman & Sterling, *U.S. Senate Banking Committee Approves a Sweeping Financial Regulatory Reform Bill* 6 (2010), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2010/04/US-Senate-Banking-Committee-Approves-a-Sweeping-__/Files/View-full-memo-US-Senate-Banking-Committee-Appro__/FileAttachment/FIA040210RevisedUSSenateBankingCommitteeApproves__.pdf.

[75] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 117.

[76] *Id.* § 165(d).

[77] *Id.* §§ 165, 619.

[78] *Id.* §§ 121, 161, 162, 172.