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Basel Bank Resilience and Liquidity Proposals Confirm the Global Paradigm Shift Toward Increased Financial Regulatory Oversight

by Gregory J. Lyons, Jeremy Hill and Edite Ligere

Following the ambitious agenda established by the G-20 finance ministers and leaders in their September meetings (discussed in more detail in the October 2009 issue of this publication available at www.debevoise.com), the Basel Committee on Banking Supervision (the "Basel Committee") in December 2009 published two proposals: "Strengthening the resilience of the banking sector" (the "Capital Proposal"),[1] which focused principally on capital issues, and "International framework for liquidity risk measurement, standards and monitoring" (the "Liquidity Proposal" and, together with the Capital Proposal, the "Basel Proposals").[2] The Basel Proposals are in addition to the Basel Committee's "Guidelines for computing capital for incremental risk in the trading book," finalized in July 2009, which a Basel Committee quantitative impact study released in October concluded would increase by two to three times the average capital requirements of an affected bank's trading book.

The Basel Committee continues to characterize its proposed and finalized rules as largely extensions of, or enhancements to, its Basel II Capital Accord ("Basel II"). However, the actions of the G-20 leaders and their regulators since the beginning of the financial crisis suggest a more fundamental paradigm shift in the underpinnings of Basel II, and regulatory oversight more generally. Since its conception, Basel II has sought to balance the desire to promote safety and soundness by prescribing certain base capital and risk measures with the desire to encourage innovation by providing banks flexibility in conducting their activities. In that regard, while pillar I (minimum capital requirements) sets forth specific capital rules pillars II and III rely on supervisory review and market sources. As then Federal Reserve Board Governor Laurence Meyer stated in a speech at the Bank Administration Institute's Conference on Treasury, Investment, ALM and Risk Management on October 15, 2001 (the "2001 Speech"), while the Basel Committee was developing Basel II, "pillar II [supervisory review] is designed to avoid the need to design rules for everything" and pillar III (market discipline) "by harnessing market discipline as another form of oversight, is also critical to avoiding an increase in regulation that would otherwise come as organizations become more complex." The Basel Proposals and other actions of the G-20 in 2009 demonstrate a dramatic loss of faith in the ability of pillars II and III to act as inhibitors of risky bank behavior. The result of the fading prominence of these pillars was presaged by Governor Meyer in a May 16, 2005 speech at the Annual Washington Briefing Conference of the Financial Women's Association, during which he stated that "supervisors have the choice of either using more invasive procedures or relying on market discipline." The fact that the Bloomberg Europe Banks and Financial Services Index fell 2.7% after the Basel Proposals were released provides evidence of this loss of faith.[3]

This article does not debate the extent to which this change in approach is justified, or whether rules that may further rein in behavior and profitability are appropriate with a fragile economic recovery underway. Instead, based on the fact that a paradigm

Basel Bank Resilience and Liquidity Proposals continues on page 9

What's Inside

Little Ado About Much: Recent U.S. Federal Data Privacy Developments

by Satish M. Kini

Over the past decade, Congress and U.S. federal regulators have focused extensively on mandating the privacy and security of consumers' personal financial data. As a result, since the enactment of the Gramm-Leach-Bliley Act ("GLB Act"), the privacy provisions of which became effective in November 2000, financial institutions doing business in the United States have faced an ever-increasing array of legal requirements regarding how they may use and how they must safeguard the non-public personal information supplied to them by their customers.

As of late this trend has continued unabated, but it has not drawn significant scrutiny due to the attention devoted to financial modernization and other reforms being considered on Capitol Hill and elsewhere. Indeed, in the last few months, Congress has been actively considering new data privacy legislation and federal regulators have issued new rules and brought several notable enforcement actions for alleged violations of federal privacy standards. This recent federal government activity has addressed an exceedingly broad array of privacy requirements, including the obligations applicable to U.S. financial services firms to (i) safeguard customer data, (ii) provide customers with notices regarding privacy policies, (iii) provide notices in cases of data breaches, and (iv) refrain from using affiliate data for marketing purposes absent the provision of a customer "opt-out." Although lost in the noise surrounding financial modernization, these developments warrant consideration, given their significant importance to financial services firms doing business in the United States.

RECENT U.S. FEDERAL DATA PRIVACY DEVELOPMENTS CONTINUES ON NEXT PAGE

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Recent U.S. Federal Data Privacy Developments

(continued from previous page)

Safeguards Requirements

The GLB Act, and the rules issued thereunder by the federal financial regulatory agencies and the Federal Trade Commission ("FTC"), essentially imposed two sets of privacy obligations on U.S. financial institutions. First, the GLB Act and the agencies' rules called on financial firms to protect the security and confidentiality of their customers' non-public personal information and to guard against threats to such data. Second, the GLB Act and its implementing regulations require firms to provide customers with notices regarding the firms' privacy policies and, in certain situations, to allow customers the right to opt out of third-party information-sharing arrangements.

For many years, federal financial regulators and the FTC focused principally on the GLB Act's notice requirement, ensuring that firms' privacy notices met applicable statutory requirements. As of late, however, regulators have intensified their scrutiny of the measures taken by firms to safeguard customers' nonpublic personal information. For example, in September 2009, the Securities and Exchange Commission ("SEC") issued a notable cease-and-desist order against a dually registered broker-dealer / investment adviser for failing to implement adequate safeguards. According to the SEC, the firm "recommended" but did not "require" its registered representatives to install anti-virus software on their personal laptop computers, which were used to access the firm's intranet. The lack of such software – which the SEC characterized as a "basic safeguard" – on certain laptops resulted in a computer intrusion by an outsider, who obtained a registered representative's log-in credentials and used them to access customer accounts and enter unauthorized trades. The SEC also cited the firm for failing to follow up on this potential security issue, even though it was brought to the attention of the firm's information technology department and was reported in a branch audit. In the SEC's view, the firm's failures evidenced a failure to adhere to "standards of reasonable design" imposed by the safeguards requirements of the GLB Act.[1]

The SEC was not alone in citing institutions for safeguards deficiencies; the FTC has also been particularly active in bringing enforcement actions for safeguards failures. In June 2009, for example, the FTC issued a complaint against a non-bank mortgage lender for safeguards and other privacy deficiencies. According to the FTC's complaint, the lender failed to provide appropriate security for the personal information it collected and stored. Among other things, the firm stored information in "clear readable text" on its network, thereby creating an unnecessary risk to the information, provided back-up tapes in "clear readable text" to a third-party service provider but did not contractually require that entity to provide for the confidentiality of the data and did not employ sufficient measures to prevent or detect unauthorized access to personal information housed on the firm's computer network.[2]

These SEC, FTC and other similar regulatory actions serve as an important reminder to U.S. financial services firms that they must develop risk-based policies and procedures to protect their systems and customer data from unauthorized access and intrusion. To this end, regulators increasingly expect firms to use anti-virus, encryption, and other technologies and to remain alert to technological developments that both pose new threats to data security and offer new ways to guard against intrusions.

Privacy Policy Notices

As noted above, since 2001, U.S. financial services firms have been obligated to provide initial and annual privacy policy notices to their customers. These notices, however, often have drawn significant criticism; many consumer groups, for example, have characterized the notices as confusing and, in some cases, misleading about information-sharing practices.

As of late ... regulators have intensified their scrutiny of the measures taken by firms to safeguard customers' nonpublic personal information.

At the behest of Congress, on December 1, 2009, federal financial regulators and the FTC issued a new model privacy form.[3] The form, which was devised after extensive research and study, is two pages long. The first page consists of the "key frame" (which provides the context to help customers understand the required disclosures), a disclosure table that describes the why, what, and how of a firm's information-sharing practices, contact information for the firm and, if needed, an opt-out box to allow customers to decline to participate in certain information-sharing arrangements. The second page provides additional explanatory information in a frequently-asked-questions format.

Firms are not required to use the new model form. However, use of the form provides a

Recent U.S. Federal Data Privacy Developments continues on next page

(continued from previous page)

safe harbor for compliance with the GLB Act's privacy notice requirements, and the form may simplify disclosures and compliance approaches for many firms. The model privacy form applies to insurance companies, since the law directing its development applies to any financial institution (which includes insurers). As required by law, the National Association of Insurance Commissioners was consulted in its development and the final regulation accompanying the model privacy form includes permissible variations for insurance products.

Data Breach Notifications

The seemingly ever-increasing number and scope of data security breaches (at entities ranging from payment processors and retailers to hospitals and government agencies) have led many states to adopt laws dictating how financial and other firms must handle customer data and report on incidents of unauthorized access or acquisition of such data. Over the past decade, 44 states have enacted data breach notice laws that require firms to inform residents of those states and, in some cases, government authorities when personal information has been compromised. Some states, such as Massachusetts, have also adopted reasonably detailed information security rules that require encryption and other specific measures be taken to protect data while in storage and transmission.

In December 2009, Congress moved a step closer to enacting the first uniform U.S. federal data security and breach notice standards. Specifically, on December 8, 2009, the House passed H.R. 2221, the Data Accountability and Trust Act (the "DATA Bill"), which, among other things, would establish a nationwide data breach notification standard and require any person owning or possessing personal data in electronic form to notify individuals and the FTC of a "breach of security of the system … that contains such data." An exception to the general breach notice requirement would exist if the breach resulted in no reasonable risk of identity theft, fraud, or other unlawful conduct (due, for example, to the use of encryption or other security methodologies). The DATA Bill would also require firms to develop policies and procedures to identify potential data security vulnerabilities, to take corrective action to address such vulnerabilities and to adopt processes for disposing and permanently deleting electronic data.

Over the past decade, 44 states have enacted data breach notice laws that require firms to inform residents of those states and, in some cases, government authorities when personal information has been compromised.

Helpfully for the many firms that have been concerned about the various and varying state laws in this area, the DATA Bill would preempt state data breach and information security laws. The bill would, however, allow state attorneys general to bring civil actions for violations of the data security and breach requirements. Penalties for such violations could be steep; the DATA Bill caps penalties at $5 million.

The DATA Bill moves next to the Senate, which has been considering its own data security and privacy bill, S. 1490, The Personal Data Privacy and Security Act of 2009 (the "Senate Bill"). The Senate Bill would establish new data security requirements for businesses and certain government agencies and require covered entities to notify individuals if their computerized personal data is breached. The Senate Bill was approved in November 2009 by the Senate Judiciary Committee and, according to press reports, Senate Judiciary Committee Chairman Patrick Leahy has stated that data security legislation is among his top priorities for the new year. It remains to be seen, however, whether data security legislation will find room on the busy Senate calendar.

Affiliate-Marketing Requirements

In December 2003, the President signed into law the Fair and Accurate Credit Transactions Act ("FACT Act"). Among other things, the FACT Act required the federal financial regulators and the FTC to issue rules governing the use of consumer information by affiliated firms for marketing purposes. The federal banking agencies and the FTC issued their affiliate-marketing rules in 2007 and required compliance with them in 2008; the SEC moved more slowly, issuing its version as Regulation S-AM in August 2009 and establishing a June 1, 2010, compliance deadline.[4]

The SEC's Regulation S-AM parallels the other affiliate-marketing rules issued under the FACT Act and, with certain exceptions, generally prohibits SEC-registered entities from using "eligibility information" regarding a consumer, when such information is provided to them by one of their affiliates, to make marketing solicitations unless (i) the

Recent U.S. Federal Data Privacy Developments continues on next page

Recent U.S. Federal Data Privacy Developments

(continued from previous page)

consumer first is given a reasonable opportunity to opt out of the solicitation and (ii) the consumer does not, in fact, opt out. Eligibility information is defined to include a consumer's transactional and account history.

The opt-out notices required under Regulation S-AM may be combined with other privacy notices, such as the privacy policy notices mandated under the GLB Act, discussed above. Unlike in the GLB Act context, annual notices are not mandated by Regulation S-AM or the other affiliate marketing rules, and opt-out elections must be honored for at least 5 years.

SEC-regulated firms will need to study Regulation S-AM closely to ensure that their affiliate information-sharing practices either comply with the notice and opt-out requirements of the rule or fit within one of its exceptions.

Conclusion

Federal privacy standards and requirements continued to evolve in the second half of 2009, and there are likely to be additional changes in 2010 as, for example, Congress considers creating a new Consumer Financial Protection Agency ("CFPA") as part of the overall federal financial modernization effort. The CFPA may have a role in establishing federal privacy requirements for some firms. As discussed above, states also continue to forge ahead with additional requirements to ensure the safety of their residents' data and to address data breach responses. Financial services firms must remain cognizant of these many developments and ensure that their compliance efforts conform to the evolving and increasingly rigorous regulatory expectations in this area. ■

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1. *See In re Commonwealth Equity Services, Securities Exchange Act Rel. 60733 (Sept. 29, 2009).*

2. *See In re James B. Nutter & Co., FTC File No. 0723108 (June 12, 2009).*

3. *See 74 Fed. Reg. 62,890 (Dec. 1, 2009).*

4. *See 74 Fed. Reg. 40,399 (Aug. 11, 2009).*

Proposed Resolution Authority for Systemically Significant Financial Companies

by Paul L. Lee

The passage of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009 ("H.R. 4173"), by the U.S. House of Representatives in December 2009 has significantly enhanced the prospects for enactment of comprehensive financial reform legislation in 2010. As passed, H.R. 4173 would make fundamental changes in the scope and nature of the financial regulatory system in the United States. Among the most important provisions in this wide-ranging bill are those that would create a new legal regime for "resolving" systemically significant financial companies. This new regime would displace the U.S. Bankruptcy Code for a non-bank financial company in favor of a bank-like resolution mechanism and would be supported by a Systemic Dissolution Fund to be prefunded by assessments on a broad range of large financial companies. The implications of the proposed resolution (or dissolution) regime for systemically significant financial companies and their creditors and counterparties have yet to be fully recognized.

Background

The need for a new resolution or dissolution regime for systemically significant financial companies has emerged as a key topic in the discussion of financial reform, particularly in respect of the "too-big-to-fail" phenomenon. The Treasury Department signaled the importance that it attached to this element of reform by releasing a detailed legislative proposal for the resolution authority in March 2009, in advance of the other components of its proposed reform package. The basic Treasury proposal for the new resolution authority has been incorporated, with several important changes, into H.R. 4173, and some version of a new resolution or dissolution authority will likely be included in the financial reform legislation that the Senate Banking Committee is now drafting. The proposal for a new resolution authority reflected in H.R. 4173 presents not only basic policy issues but also important legal and financial issues that require careful attention.

Proposed Resolution Authority continues on next page

Proposed Resolution Authority

(continued from previous page)

Policy Implications

When the Treasury Department first proposed a new resolution authority for systemically significant financial companies in March 2009, it stated that its legislative proposal would fill a significant void in the existing financial regulatory structure for non-bank financial institutions, a void that had been highlighted during the recent financial crisis. The Treasury Department said that the events of the financial crisis had demonstrated that when a large, interconnected non-bank financial institution encounters severe distress, there are only two options for the institution: (i) obtain emergency funding from the U.S. government (as in the case of AIG) or (ii) file for bankruptcy and undergo a "disorderly" failure that threatens the stability of the entire financial system (as in the case of Lehman Brothers). Faced with a choice between these two "untenable" options, the U.S. government chose to use the Federal Reserve's lending authority to avoid disorderly failures of Bear Stearns and AIG. The Treasury Department has now proposed that the U.S. government needs another option for dealing with systemically significant financial companies. This option would be in the form of a new resolution authority that parallels the speed and flexibility of the resolution authority for insured banks under the Federal Deposit Insurance Act. The Treasury Department initially proposed a resolution authority that would allow the Federal Deposit Insurance Corporation (the "FDIC") to act as a receiver or conservator for any firm deemed to be systemically significant, with powers comparable to those available to the FDIC for insured banks and with the additional authority to provide various forms of financial assistance to stabilize the financial firm. In what could be seen in hindsight as a potential political misstep, the Treasury Department noted that the new authority was modeled on the FDIC's existing resolution authority with respect to insured banks and on the Federal Housing Finance Agency's resolution authority with respect to government sponsored enterprises. The latter indirect allusion to the conservatorship treatment of Fannie Mae and Freddie Mac exposed the Treasury Department to the criticism that its proposal would provide a source of ongoing federal assistance to a company on financial life-support. Amendments were made to the resolution proposal in H.R. 4173 to remove the conservatorship option and to require that any government assistance provided as part of the process be repaid in full only from non-taxpayer funds, *i.e.*, from assessments on other financial companies. The language of H.R. 4173 was also amended throughout to speak in terms of "dissolution" rather than "resolution" in order to reinforce the notion that the new authority is an authority to liquidate, not rehabilitate.

One of the other criticisms of the Treasury's proposal for new mechanisms to regulate and to resolve systemically significant financial firms has been that the creation of these mechanisms would have the perverse effect of reinforcing the "too-big-to-fail" phenomenon. U.S. Secretary of the Treasury Timothy Geithner has testified that while there is no way to eliminate completely the "too-big-to-fail" phenomenon, the effects of the phenomenon can be substantially mitigated if there is an enhanced regulatory regime that imposes higher capital and other prudential requirements on large financial firms, and if there is a credible resolution mechanism that imposes losses on shareholders and creditors but also allows an orderly wind-down of the institution. In the words of the Treasury Department, the goal of the new resolution mechanism would be to minimize the impact of the failure of a financial institution on the financial system as a whole rather than "simply addressing the rights of the institution's creditors as in bankruptcy." The potential trade-offs between these considerations have not been fully articulated by the Treasury Department, nor are they fully bounded by the language of the legislative proposal.

... [T]he existing resolution scheme in the Federal Deposit Insurance Act has been developed and implemented for depository institutions and has not been tested in application to diversified financial companies with a range of businesses and structures.

Legal Implications

Although the proposed resolution scheme is based on a relatively well-established scheme for insured depository institutions, it is important to note that the existing resolution scheme in the Federal Deposit Insurance Act has been developed and implemented for depository institutions and has not been tested in application to diversified financial companies with a range of businesses and structures. This introduces a substantial element of uncertainty to the operational effectiveness and resiliency of

Proposed Resolution Authority continues on next page

the new resolution authority, particularly as applied to large, complex companies. It is likewise important to note that the proposed resolution authority, like the existing FDIC resolution authority for banks, would operate essentially as an administrative process and, unlike a bankruptcy process, with minimal judicial oversight. The FDIC, as receiver for a systemically significant company, would make decisions about the scope of its new authority and the means of implementing this authority with only *ex post facto* judicial review. The scope of even this *ex post facto* review is unclear under the legislative language. However, under any reading of the legislative language, the FDIC as receiver would have broad powers to deal with the financial company. This would include the power to sell or transfer all or parts of the assets and liabilities of such a company to a new "bridge" financial company or other third party without court approval or consent from creditors or counterparties. The FDIC would also be authorized to discriminate in payment among unsecured creditors, if necessary, to minimize losses or to address systemic risk, provided that claimants that are similarly situated receive at least as much as they would have received had the company been liquidated under the Bankruptcy Code. A parallel provision would allow the FDIC to make "additional payments" to a claimant or a category of claimants to mitigate serious effects on financial stability. Presumably, the source of funding for these additional payments would be the Systemic Dissolution Fund established to support the new resolution authority.

The treatment of secured creditors under the new regime also requires special attention. Although a provision permitting a 20% "haircut" on secured claims was modified in the final amendment process for H.R. 4173, the bill as passed still permits a 10% "haircut" on a qualified financial contract with an original term of 30 days or less secured by collateral other than U.S. government and agency securities. Interpretive issues for secured creditors may also lurk in other sections of the bill, such as in the provision that states that the succession of the FDIC as receiver "shall terminate all rights and claims that the stockholders or creditors … may have against the assets of the covered financial company … except for their right to payment…." In addition to these new provisions in the resolution authority, the incorporation and application of existing provisions from the Federal Deposit Insurance Act will also result in different outcomes than creditors could expect in a bankruptcy proceeding. For example, the existing FDIC receivership provisions provide (i) for authority to repudiate both executory and non-executory contracts, (ii) for damages generally limited to actual direct compensatory damages and (iii) for authority to avoid security interests taken in contemplation of insolvency.

Perhaps more than any other provision in the new resolution authority, the prospect of a direct assessment has served to concentrate the minds of many in the financial sector.

Financial Implications

The prospect of the new regime, with rules that differ in various respects from those applicable under the Bankruptcy Code, will likely lead to increased financing costs for those financial companies that the market perceives as potentially being subject to the new regime. There are other provisions in H.R. 4173 that are expressly designed to impose higher costs on systemically significant financial companies, as for example through increased capital or liquidity requirements. The provisions of the new resolution authority may not fall into this category, but they are nonetheless likely to have the effect of imposing higher costs indirectly. In addition, there is one provision in the new resolution authority that would expressly impose a direct cost on a broad range of financial companies. This is the provision that requires the establishment of a $150 billion Systemic Dissolution Fund through assessments on financial companies with consolidated assets of $50 billion or more and financial companies that manage hedge funds with $10 billion or more of assets under management. Perhaps more than any other provision in the new resolution authority, the prospect of a direct assessment has served to concentrate the minds of many in the financial sector. The prefunding requirement, the methodology for assessment and the scope of financial companies subject to assessment will all be topics of intense scrutiny in the debate over the new resolution authority in 2010. ■

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Implications of the Tax Extenders Act of 2009

By Seth L. Rosen, Robert J. Staffaroni and John C. Lynch

The Tax Extenders Act of 2009 ("TEA") was passed by the U.S. House of Representatives on December 7, 2009. It is still subject to Senate approval and could be revised substantially. In its current form, TEA contains a number of provisions of interest to financial institutions, including (i) a one-year extension of the Subpart F exceptions for certain banking and insurance income of controlled foreign corporations, (ii) a one-year extension of the look-through rules for certain interest and short-term capital gains on regulated investment company shares held by foreign investors, (iii) the repeal of the rules permitting foreign-targeted offerings of bearer bonds, except for purposes of the TEFRA excise tax (in effect generally allowing continued issuance by foreign issuers), effective for issuances after the second anniversary of enactment, (iv) look-through treatment for withholding purposes of payments in respect of U.S.-source dividends under certain equity swaps and (v) a requirement that certain foreign entities certify as to their U.S. owners in order to claim relief from U.S. withholding tax on "withholdable payments" (generally U.S.-source interest, dividends, compensation and similar income, as well as the gross proceeds from the disposition of property that produces such income, other than income that is taxable as income connected with a U.S. business). As briefly described below, TEA also would substantially revise the U.S. withholding rules with respect to withholdable payments to foreign financial institutions ("FFIs").

Withholding Tax

A 30% withholding tax generally would apply to withholdable payments to an FFI that does not enter into an agreement with the IRS under which, among other things, it and its affiliated FFIs agree to report information with respect to "United States accounts" and to withhold tax on payments to uncooperative account holders and non-complying FFIs. Withholding generally would be required even if the payment would otherwise be exempt (e.g., under a tax treaty or the portfolio interest exemption), and even if the payment is for the account of the FFI itself and not an undisclosed accountholder. If any tax is withheld from payments to a non-complying FFI for its own account, it may claim a refund to the extent provided under a U.S. tax treaty, but may not claim the portfolio interest exemption.

... [T]he compliance burden on FFIs will depend to a great extent on the manner in which the IRS exercises its discretion to implement the new rules.

The term "financial institution" includes banks as well as other entities that are in the business of holding financial assets for others or investing or trading in such assets, and thus may include hedge funds and private equity funds. The term "United States account" generally means a depository or custodial account, and certain non-traded debt and equity interests in a foreign financial institution, held by a U.S. person or certain foreign entities with U.S. owners.

In short, the potential reach of this provision, as currently drafted, is extremely broad. If it is enacted, the compliance burden on FFIs will depend to a great extent on the manner in which the IRS exercises its discretion to implement the new rules.

Implementation and Grandfather Rule

In its current form, the new withholding tax generally would apply to payments made after December 31, 2012, but would not apply to payments made "under any obligation outstanding on the date which is two years after the date of enactment." We would expect that this grandfather rule generally would cover payments on outstanding debt obligations, but not on outstanding shares. Presumably, TEA's intention is that gross proceeds from the disposition of an outstanding obligation would be grandfathered under this rule, although the language is not completely clear. The technical explanation of TEA indicates that the IRS may provide guidance on how the Treasury regulations treating certain modifications of debt instruments as deemed exchanges apply for purposes of the grandfather rule.

The delayed effective date and the grandfather rule for outstanding obligations take much of the pressure off term loans and debt securities issued in the interim period, although it is not clear at this point when grandfathering will be lost in the event of substantial loan modifications. It is also not clear at this point how the grandfather rule for outstanding obligations would apply to (for example) revolving credit facilities or letter of credit facilities.

Tax Extenders Act of 2009 continues on next page

Tax Extenders Act of 2009

(continued from previous page)

Potential Implications for Credit Facilities

Credit facilities generally provide for U.S. borrowers to pay a gross-up in respect of U.S. withholding tax imposed as a result of a change in law, subject to certain exceptions and mitigation provisions. With regard to credit agreements not yet executed, the potential effects of the new withholding tax included in the current version of TEA should be considered. U.S. borrowers may not view the new tax as being appropriately covered by their gross-up, as the tax would not apply if foreign lenders were to comply with the new reporting and related requirements and borrowers have no control over foreign lenders' compliance. Some foreign lenders, on the other hand, may view the new tax as simply a change in law and may not relish the thought of taking on new wide-ranging U.S. compliance obligations. While FFIs with substantial U.S. assets may have little choice but to accede to new U.S. compliance obligations if TEA is enacted, it is not clear at this point how other FFIs will react.

For credit agreements that are already in place, the new withholding tax could potentially become relevant, as noted above, in the event of a modification of the terms after 2012 or borrowings or letters of credit issued after 2012. The impact of the tax will depend on the particular language in the tax provisions of the agreement. Where assignments or participations by lenders are subject to borrower consent, borrowers may take the potential impact of the new tax into account in deciding whether to consent. ■

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Basel Bank Resilience and Liquidity Proposals

(continued from cover)

shift (as opposed merely to an extension or enhancement) has occurred, this article's discussion of the Basel Proposals will focus on the substantial additional capital and liquidity requirements, as well as the significant increase in compliance, risk management, and systems time and expenses, that are likely coming. This article will also discuss several of the significant ramifications of this heightened regulation. For example, this paradigm shift is also likely to be relevant to internationally focused financial firms, including insurance companies, brokerage firms and perhaps even large fund firms, given the new international focus on systemically important *financial* institutions as opposed to the traditional focus of many of the Basel Proposals in the U.S. on large, internationally active *banking* institutions. Moreover, given the broader application of Basel II outside the U.S., and the desire for U.S. and other regulatory agencies to prescribe "best practices" across all their regulated institutions at both the supervisory and examiner levels, even regional and smaller financial institutions may feel the reverberations of the G-20 response to the financial crisis.

The Basel Proposals

The Capital Proposal

The Capital Proposal asserts that the financial crisis became so severe because the banking institutions in many countries had incurred excessive on- and off-balance sheet leverage while holding insufficient liquidity buffers. As a result, banks could not mitigate their systemic trading or credit losses or address the migration of off-balance sheet exposures onto their balance sheets. These problems were exacerbated by the pro-cyclical de-leveraging process after the crisis began, and by the interdependency of financial institutions.

To address these concerns, the Capital Proposal would (i) increase the required quality and quantity of the capital base (the numerator of the regulatory capital ratios), (ii) increase risk-weighted asset assessment for certain types of activities (the denominator of the risk capital ratios), (iii) introduce a leverage ratio as an addition to the risk-capital ratios that historically have been the exclusive capital measure in Basel II and (iv) create pro-cyclicality buffers and protections against interdependency of financial institutions to address the variation of capital levels at various points in an economic cycle and the fear of contagion upon the distress of any major financial institution, respectively. If finalized in its current form, the Capital Proposal likely will force many banking institutions in North America, Europe and Asia to raise significant amounts of common equity, the most expensive form of capital. These proposals also may force many of them to exit, or at least significantly reduce,

Basel Bank Resilience and Liquidity Proposals continues on next page

their exposure to certain trading, derivatives, securities finance and securitization operations.

Capital Base. The Basel Committee expressed concern that "innovative" and "hybrid" Tier 1 capital instruments (often designed for tax benefits), combined with the fact that regulatory adjustments (such as goodwill) are deducted from general Tier 1 capital rather than specifically from a common equity measure, resulted in many financial institutions holding common equity that was as little as 2% of risk-based assets before the crisis. Accordingly, the Capital Proposal seeks to simplify and harmonize the capital standards (and eliminate subtiers of capital) across jurisdictions, and (after calibration in the first half of 2010) to establish separate capital requirements for common equity, Tier 1 capital, and total capital. Broadly speaking, Tier 1 capital would consist only of capital that can absorb losses on a going concern basis, while Tier 2 capital would consist only of capital able to absorb losses on a "gone" concern basis. Tier 3 capital (which supports market risk) would be eliminated, as the Basel Committee believes that capital to support market losses is no less significant than other sources of capital. While the Capital Proposal focuses on stock corporations, it notes that the same principles should be used when evaluating capital categories for non-stock institutions, stating that in "the rare cases where banks need to issue non-voting common shares as part of the predominant form of Tier 1 capital, they must be identical to voting common shares in all respects except the absence of voting rights."

With respect to Tier 1 capital, the Capital Proposal would establish separate minima for common equity and total Tier 1 capital, and the predominant form of Tier 1 capital would be required to be voting common shares and retained earnings. The common equity-based Tier 1 capital must, among other things, (i) represent the most subordinated claim in a bank's liquidation, (ii) have perpetual principal that is never repaid outside of liquidation, (iii) do nothing to create an expectation that the instrument will be bought back, redeemed or cancelled and (iv) not be secured or guaranteed by the issuer or any related entity. The non-common equity-based Tier 1 capital must, among other things, (i) be perpetual, without any maturity date or any incentive to redeem, (ii) be callable only after at least 5 years, and only then with regulatory approval and (iii) provide the issuer with the ability to cancel distributions at any time, with no restrictions imposed on the bank. The Capital Proposal expressly provides that current Tier 1 capital instruments with step-ups or similar "innovative" or "exotic" traits will be phased-out. This phase-out likely could disqualify, for example, U.S. trust preferred securities from Tier 1 capital.

Further emphasizing the importance of maintaining a strong common equity base, regulatory adjustments to capital would be made for the most part at the common equity, rather than merely the Tier 1 capital, level. Notable adjustments include (i) deducting minority interests, currently generally included in Tier 1 capital, from common equity, (ii) fully reflecting unrealized gains and losses, currently excluded in many jurisdictions from Tier 1 capital calculations, in common equity and (iii) deducting goodwill and other intangibles (presumably including the servicing assets currently included in Tier II in the U.S.), as well as deferred tax assets that would only be realized upon future profitability of the bank, from common equity. The deduction of goodwill from common equity could be a significant consideration in certain acquisitions.

> **… [T]he Capital Proposal seeks to simplify and harmonize the capital standards (and eliminate subtiers of capital) across jurisdictions ….**

Tier 2 capital also would be tightened by establishing a single set of criteria to qualify as Tier 2 capital, including that the instrument (i) be subordinate to depositors and general creditors of the bank, (ii) not be secured or covered by a guaranty of the issuer or any related entity, (iii) have an original maturity of at least 5 years, with no incentive to redeem, (iv) provide the investor no right to accelerate the payment, except in bankruptcy or liquidation and (v) not have a credit-sensitive dividend feature. The Capital Proposal includes only securities in Tier 2 capital. As a result, allowance for loan and loan losses, which currently is a component of Tier 2 capital, would appear to be excluded. As to disclosure, the proposal essentially requires banks to make public their various capital components (as described above), as well as capital requirements and levels.

Risk-Weighted Assets. As stated above, in July the Basel Committee finalized rules that significantly raise the capital requirements for a bank's trading book exposures. The Capital Proposal focuses on counterparty credit risk ("CCR"), which is the risk that a counterparty to a transaction could default before the final settlement of the transaction's cash flows. (CCR transactions, unlike typical loans, create a bilateral risk of

Basel Bank Resilience and Liquidity Proposals continues on next page

loss.) Derivatives, securities finance and securitization activities are a particular focus of the Capital Proposal's CCR-related amendments. The Basel Committee decided to propose these changes, among other reasons, because of its determination that during the financial crisis several risks were not properly captured in the capital components of Basel II, including that (i) the credit worthiness of trading counterparties was adversely correlated with volatility and exposure to the counterparty (*i.e.*, "wrong way risk"), (ii) approximately two-thirds of CCR losses resulted from mark-to-market losses due to credit valuation adjustments ("CVAs"), and the current rules account for default risk but not market value losses short of default, (iii) securitizations were treated as having the same risk as similarly rated corporate debt instruments, (iv) the close-out period for large or illiquid netting sets often extended beyond the calculation period and (v) large financial institutions were more interconnected and interdependent than is currently reflected in Basel II.

The Capital Proposal contains several specific modifications to Basel II to address these and other concerns identified by the Basel Committee. For example, to address wrong-way risk, the Capital Proposal (consistent with the recently finalized trading book rules) contemplates that a stressed effective positive exposure be used to calculate exposure at default ("EAD") for purposes of Basel II. For potential CVA losses, the Capital Proposal would treat the counterparty exposure as the equivalent of a bond, resulting in a capital add-on using a bond equivalent as a proxy for CVA risk (with the notional amount of the bond being the counterparty EAD and its maturity being the longest dated netting set involved). In addition, the Capital Proposal incorporates a number of other technical changes that increase required capital under the Basel II formulae in response to perceived shortcomings in evaluating CCR in the context of certain risks, including (i) applying a 1.25 multiplier to the asset value correlation (a) of certain regulated financial firms (banks, broker-dealers and insurance companies with assets exceeding $25 billion) and (b) of all unregulated financial firms (including highly leveraged firms, such as hedge funds), (ii) to ensure the suitability and sufficiency of collateral under the Internal Model Method ("IMM"), extending the minimum margin period of risk to 20 days for over-the-counter ("OTC") derivatives (typically having a minimum margin period of 10 days) and securities financing (typically 5 days) netting sets if the number of trades exceeds 5,000 at any point during a quarter or if the netting sets contain illiquid collateral or hard-to-replace (*e.g.*, bespoke or exotic) derivatives and (iii) enhancing the incentives to use central counterparties for OTC derivatives transactions by increasing the assessed capital requirements against such exposures if completed on a bilateral basis.

Like the addition of explicit capital charges, the Capital Proposal would also impose specific additional bank compliance and risk management requirements on these types of CCR transactions in lieu of the more flexible standards currently in place that provide substantial discretion to the banks. For example, the Capital Proposal expands and makes more detailed the quantitative requirements in Annex 4 of Basel II for stress testing by banks using the IMM, requiring, for example, monthly exposure stress testing of principal market factors, and at least quarterly testing of multifactor stress testing scenarios. In addition, the proposal would impose more detailed back testing requirements (not allowing value-at-risk-based back testing to substitute for CCR back testing). The Capital Proposal also devotes particular attention to the collateral management units of banks using the IMM, specifically prescribing the need for such a unit and the substance of necessary reports, as well as audit, staffing and regulatory requirements. Finally, the Capital Proposal provides incentives to ensure that banks do not rely on credit ratings for exposures without conducting their own diligence on their counterparties.

Leverage Ratio. Early in the Basel II process, many assumed that as Basel II's sophisticated capital and risk management procedures were implemented, the simplistic leverage ratio that the U.S. historically has imposed on banks would be phased out. Indeed, as late as 2004 in hearings before the U.S. Senate Banking Committee, Alan Greenspan referred to Basel II and a leverage ratio as being "mutually exclusive."[4] The imposition of a leverage ratio on banks worldwide in the Capital Proposal thus represents one of the clearest reversals yet seen of reliance on internal risk models in favor of externally imposed, mechanical rules. The Basel Committee is introducing a leverage ratio globally, to prevent excessive on- and off-balance sheet leverage and the associated economic damage resulting from de-leveraging during difficult economic periods. To ensure consistent implementation internationally, the leverage ratio will be implemented in a manner that takes into account different accounting principles in various jurisdictions.

The Basel Committee is focusing on whether common equity, or Tier 1 capital, is preferable for the numerator of the leverage ratio, although the Basel Committee "also will collect data on total regulatory capital." As to the denominator, largely consistent with the U.S. approach, the Capital Proposal generally contemplates that the measure of exposure for the leverage ratio will follow accounting principles. The currently

Basel Bank Resilience and Liquidity Proposals continues on next page

Basel Bank Resilience and Liquidity Proposals

(continued from previous page)

proposed leverage ratio would not allow accounting or regulatory netting (including for derivatives and repo-style transactions), and is contemplated to include all assets considered to be on-balance sheet for accounting purposes, such as high quality liquid assets, repo-style transactions, securitizations (including to the extent considered on-balance sheet under FAS 140) and derivatives. Moreover, because the Basel Committee sees them as a "source of potentially significant leverage," the Capital Proposal would include certain off-balance sheet items, such as commitments, direct credit substitutes, failed transactions and unsettled securities using a 100% credit conversion factor. Finally, the actual leverage ratio required will be part of the 2010 impact assessment, including its interaction with the risk-based measure.

> **The Capital Proposal ... seeks to limit bank discretion ... by proposing a framework to reduce the ability of banks to distribute funds during times of stress ....**

Procyclicality. The Capital Proposal also "promot[es] stronger provisioning practices" to reduce the procyclical nature of bank lending in the economy. The proposal encourages the International Accounting Standards Board to move to an "expected loss approach" that would permit banks to make provisions for loan losses based on expected losses over the life of the portfolio, rather than the current "incurred loss" approach. The proposal also encourages banks to adopt an additional capital buffer as a "best practice."

However, the Capital Proposal also expresses concern that, rather than engaging in best practices, in the recent crisis banks continued to pay dividends and make other "discretionary" expenditures of their capital, including bonuses, even after their capital position deteriorated. The Capital Proposal therefore seeks to limit bank discretion in this area as well by proposing a framework to reduce the ability of banks to distribute funds during times of stress, with additional constraints coming into effect the closer a bank's capital falls toward the minimum capital levels. For example, under the proposed framework, if a bank's capital falls to 50% of the buffer set by the regulators above the minimum capital ratios, the bank's capital conservation ratio would be 60%, meaning that in the subsequent year the bank could pay out, in the aggregate, no more than 40% of its earnings through dividends, share buybacks or discretionary bonus payments. In addition, the Capital Proposal also contemplates adjusting the capital buffer range described above if a bank's overall credit grows to levels deemed by regulators to be "excessive." This reduction in credit extension discretion is not very concrete in the Capital Proposal, but the Basel Committee committed to "review a fully fleshed out approach" in its upcoming July 2010 meeting.

The Liquidity Proposal

As recently as September 2008, the Basel Committee addressed liquidity extensively in its "Principles for Sound Liquidity Risk Management and Supervision."[5] However, given the Basel Committee's perception that poor liquidity risk management was a significant contributor to the financial crisis, and further evidencing the change to a more regulation-predominant environment, the Basel Committee published the Liquidity Proposal to propose specific, concrete short-term ("Liquidity Coverage Ratio") and longer-term ("Net Stable Funding Ratio") liquidity standards for banking institutions.

Liquidity Coverage Ratio. The Liquidity Coverage Ratio seeks to ensure that banks will have a sufficient level of unencumbered high quality assets (*i.e.*, assets easily converted to cash at no material loss of value, and ideally eligible as collateral at central banks) over a stressed 30-day period by mandating that, on a continuous basis, the value of such assets held by a bank (the numerator) be at least equal to 100% of the bank's estimated net cash outflows (the denominator) during that period. The basic premise is that a 30-day liquidity reserve will provide the bank and the regulators time to respond before the bank's condition becomes critical, or to enable it to be resolved in an orderly manner. The numerator generally would include cash, central bank reserves and marketable securities representing claims on or guaranteed by sovereigns and multi-national quasi-governmental organizations. In addition, up to specified levels and subject to certain haircuts, the numerator may include high grade, plain vanilla non-financial corporate bonds, and covered bonds (*i.e.*, bonds issued by a bank and subject to special supervision designed to protect bond holders).

As indicated above, the denominator of the Liquidity Coverage Ratio is equal to cumulative expected cash outflows minus cumulative expected cash inflows over a 30-day period. For expected cash outflows, the Liquidity Proposal details various potential sources of liquidity and prescribes various levels of expected run-off or other outflows that banks must include in their calculation. For example, certain stable

Basel Bank Resilience and Liquidity Proposals continues on next page

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deposits only have a 7.5% "run-off factor," unsecured wholesale funding by non-financial corporate customers has at least a 25% run-off factor, committed credit and liquidity facilities are expected to cause liquidity outflows of between 10% and 100% of the line and asset-backed commercial paper, conduits, and securities finance and derivative transactions also have detailed rules that generally assume significant outflows. Notably, at the discretion of the local supervisor, the denominator also potentially involves off-balance sheet contingent funding liabilities, such as guarantees and letters of credit, as well as non-contractual obligations that may create material reputational risk. As to cash inflows, the Liquidity Coverage Ratio also proposes specific percentages for expected retail and wholesale contractual inflows (generally 100%), reverse repos and secured lending, and other potential sources.

Net Stable Funding Ratio. Whereas the Liquidity Coverage Ratio focuses on short-term stressed conditions, the Net Stable Funding Ratio ("NSFR") seeks to establish a minimum amount of funding based on the liquidity of a bank's assets and activities over a one-year time horizon. In other words, the NSFR seeks more fundamentally to restructure the components of a bank's balance sheet. Like the July 2009 trading rules and much of the risk-weighted asset discussion of the Capital Proposal, much of the focus of the NSFR is on non-traditional bank activities, with the Liquidity Proposal providing that "[i]n particular, the NSFR standard is structured to ensure that investment banking inventories, off-balance sheet exposures, securitization pipelines and other assets and activities are funded with at least a minimum amount of stable liabilities in relation to their liquidity risk profiles." As with the Liquidity Coverage Ratio, the numerator (available amount of stable funding, or ASF) must be equal to at least 100% of the denominator (assets and off-balance sheet exposures). In arriving at the result, the components of the numerator are multiplied by percentages depending on their category in a table, ranging from 100% for very stable funding (*e.g.*, Tier 1 and 2 capital), to 0% for any liability or equity category not specified in the table.

... [T]he Net Stable Funding Ratio ... seeks to establish a minimum amount of funding based on the liquidity of a bank's assets and activities over a one-year time horizon.

The denominator of the NFSR operates in the same manner using a table with very liquid assets (*e.g.*, cash, securities with a maturity of less than 1 year) having a 0% multiplier, gold having a 50% multiplier, loans to retail clients with a maturity of less than 1 year having an 85% multiplier, and all non-designated assets having a 100% multiplier. As is the case with the Liquidity Coverage Ratio, the denominator also includes off-balance sheet assets at the discretion of the local regulator. The specificity of the pre-asset liquidity changes in the NSFR, along with the Liquidity Coverage Ratio, demonstrates the granular approach to regulation that the Basel Committee (following the agenda of the G-20) intends to adopt going forward.

Monitoring. In addition to the ratios set forth above, the Liquidity Proposal also would impose additional monitoring requirements on affected banking institutions and would describe how that monitoring must occur. The specified monitoring includes metrics to identify contractual maturity mismatches, concentration of funding, and available unencumbered assets. The Liquidity Proposal specifies that banks should calculate these metrics at least monthly (more often during stressed situations), and information on the metrics should be publicly disclosed.

Timing

The Basel Committee published both the Capital Proposal and the Liquidity Proposal in December 2009, and comments on both documents are due by April 16, 2010. The Basel Committee plans to conduct quantitative impact assessments during the first half of 2010 in order to calibrate the standards appropriately by the end of 2010. (Recent experience with the trading book rules, in which a quantitative assessment demonstrated that the capital increase would be two to three times historical standards but no relief was given in the final rules, provides some evidence of the challenge financial institutions will have reducing the capital and liquidity burdens of the Basel Proposals.) Implementation of the rules is then expected to be phased-in by the end of 2012. As part of the phase-in, the Basel Committee will consider transitional and grandfathering arrangements, although the long transition period contemplated by some before the Capital Proposals were published now appears unlikely.

Ramifications of, and a Suggested Approach to, the New Regulatory Environment

The capital and liquidity requirements directed at particular financial institution activities detailed above, together with the trading book rules and other actions taken

Basel Bank Resilience and Liquidity Proposals continues on next page

and directed to be taken by the G-20 after the crisis, confirm that banking institutions now live in an era of increased regulation. The previous approach of viewing regulation as a complement to market forces has been supplanted by one in which banks must look at regulation as potentially the single most significant driver of their future growth and activities. Given this, we conclude with several general observations about regulatory trends and ramifications for financial institutions to consider.

> **... [A] banking organization choosing to focus on ... non-traditional banking activities likely can expect to have significantly higher capital and liquidity requirements, along with more oversight and expenditures for systems and compliance, than a more traditional bank of similar asset size.**

All "Too-Big-to-Fail" Institutions Are Not Created Equal – Investment Banking Activities in Disfavor

The U.S. Gramm-Leach-Bliley Act of 1999 and similar laws and regulations elsewhere facilitated the creation of large, complex financial institutions, which were seen to have a sufficient diversity of revenue streams to withstand a downturn in particular sectors of the economy. The legislative proposals since the financial crisis began (*e.g.*, in the U.S. the potential designation of "systemically significant" financial institutions that, among other things, must hold more capital and be subject to more oversight than smaller institutions, as well as a recent U.S. proposal to reinstate Glass-Steagall) evidence a strong regulatory reversal and preference for smaller, less complex institutions.

However, as the Basel Proposals described above and the trading book rules that were finalized in July also demonstrate, not all bases of being considered "too big" are treated equally. The substantially increased capital and liquidity charges for activities of the type generally occurring in investment banks (such as trading book, securities finance, derivatives, and repo activities) strongly suggest that the Basel Committee wants to induce banking organizations to become more dedicated to traditional banking functions. Stated differently, if these proposals become effective, a banking organization choosing to focus on these non-traditional banking activities likely can expect to have significantly higher capital and liquidity requirements, along with more oversight and expenditures for systems and compliance, than a more traditional bank of similar asset size. Given that investment banking activities represented a significant percentage of the revenue over the past year for many of the larger banking groups, this aspect of the new regulatory regime may put significant pressure on profits in the near term.

Politics Is Local ... and Global ... and Uncoordinated

During his 2001 Speech, Governor Meyer sought to justify why the Basel Committee had been working on Basel II for 5 years without significant demonstrable progress by explaining that "[a]s in medicine, the first principle should be, 'do no harm.'" This cautious approach has been superseded in the new environment by a desire to effectuate change quickly in order to demonstrate action and to ensure the crisis does not recur. Whatever the reason, as lawmakers and regulators have raced to prescribe new regulatory limitations in areas historically left to bank discretion and market discipline, the sheer volume of finalized and pending laws and regulations has grown exponentially.

This atmosphere creates a number of challenges for the financial services industry. For example, less than a week prior to the publication of the Basel Proposals, the UK Financial Services Authority (the "FSA") published its Consultation Paper 9/29 "Strengthening Capital Standards 3," which in turn is based on the EU's amended Capital Requirements Directive. Comments on the FSA's proposal are due by March 10, 2010, with the new rules expected to apply in 2011. Substantively, the FSA's proposal is similar but not identical to the July trading book rules and the Basel Proposals. For example, unlike the Capital Proposal, the FSA proposal would permit capital instruments with "step ups" and other incentives to redeem to count as Tier 1 capital to a degree. Nonetheless, the FSA estimates that its rules will necessitate a U.S. $54 billion, or 5%, increase in the total capital held by affected banks, with much of that increase occurring by 2011.[6] While it is unclear why the FSA chose to promulgate this proposal contemporaneously with the more comprehensive Basel Proposals (the U.S. banking agencies chose simply to issue a press release encouraging affected institutions to comment on the Basel Proposals), what is clear is that the need to track, comment upon, and (given the short

Basel Bank Resilience and Liquidity Proposals continues on next page

time frame) establish systems to comply with overlapping and inconsistent regulation will prove challenging and expensive to the industry. Moreover, although it was not directly targeted at banks, the Japan Financial Supervisory Agency's "Draft Blueprint for the Development of Institutional Frameworks Pertaining to Financial and Capital Markets," published on December 17, 2009, further focuses on, and thus increases burdens associated with, OTC derivatives transactions, securities clearing and settlement systems and their operators.

In addition, in the United States rules have recently been put into place limiting overdraft and credit card fees, thereby reducing bank revenues, that are likely to be effective at the same time that the Basel Proposals (which will increase capital and liquidity requirements and compliance expenses) will go into effect. While in isolation one or even a subset of these proposals might not have a material effect on the banking industry, the consolidated financial impact of all the domestic and international proposals on the industry must be considered. While variation between international and local law has always existed, the increasing prominence of regulation in the financial industry increases its impact. As indicated above, beyond any required increase in capital and liquidity, and any resulting reduction of revenue, the compliance and systems expense and effort required to comply with a patchwork of laws across multiple jurisdictions could prove costly to a financial institution seeking to recover from the crisis. The Basel Proposals are at least a move toward consistency, but the individual actions of local governing bodies, as well as the absence of any structure by which one could calculate the global costs of their collective efforts, will create significant challenges in assessing and responding to any proposal. For example, among other things, a financial institution in the United Kingdom now must consider how to comply with recently finalized Solvency II, the Basel Committee trading book rules finalized in July 2009, "Strengthening Capital Standards 3" (proposed in December 2009) and the Basel Proposals, all of which overlap but are inconsistent and/or are subject to revision in light of comment periods and later proposals. Particularly if that financial institution were near a 2% common equity to risk-weighted assets ratio, the burdens of navigating the current market environment to ensure that it remains a safe and sound operation, while also devoting substantial time and expense to these directives and their permutations, may prove to be challenging indeed over the coming months and years.

Financial Institutions Must Actively Engage in the Debate Now

As discussed above, the environment in which large banking institutions, and most likely other types of financial institutions, have existed is changing rapidly. Most financial institutions still are understandably focused first and foremost on recovering from the financial crisis. However, the importance of remaining cognizant of, and fully engaged in, local and international regulatory developments cannot be overstated. Governing bodies have established aggressive timetables to complete their work, with even dramatic proposals such as those promulgated by the Basel Committee (and the FSA) expected to be substantially completed by the end of this year. Harmonizing inconsistent rules, calibrating and adjusting to known impacts from global efforts and avoiding unintended consequences and the disintermediation of regulated institutions from the market all are critical near-term objectives. Because it is based on vigorous regulation, regardless of any "transition period," once this new firmament has hardened it will be difficult to change.

Conclusion

Financial institutions are entering a new era with a potentially substantial imbalance between regulatory and market forces. If government action and discourse to date is any guide, financial institutions likely will not be able to prevent this change. However, by remaining actively engaged in the process, they may be able to shift the debate sufficiently to avoid some of the most challenging intended and unintended consequences of the new landscape. The window to influence the discussion, however, may be relatively short. ■

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