FINANCIAL POLICY FORUM
DERIVATIVES STUDY CENTER
www.financialpolicy.org 1333 H Street, NW, 3rd Floor
rdodd@financialpolicy.org Washington, D.C. 20005

PRIMER

KEY REGULATORY EVENTS, AND KEY REGULATORY INSTITUTIONS, IN THE UNITED STATES

Randall Dodd
Director
Financial Policy Forum
March 20, 2006

Key Regulatory Events

BACKGROUND – Milestones for US Regulation

1922 – Grain Futures Act
The first federal law regulating the trading in derivatives. The act was limited to prohibiting fraud and manipulation on futures contracts on wheat, corn, sorghum and other grains.

1933 – Glass-Steagall Banking Act of 1933.
Separates commercial from investment banking activities. Created FDIC to administer the deposit insurance program. It prohibited paying interest on demand deposits. Amended McFadden Act to permit national banks to branch within a state to the same extent that state chartered banks are permitted. (Carter Glass had his picture on the currency at some point.)

1933 – Securities Act

In response to stock market crash and the massive fraud that was linked to it, this Act established disclosure requirements for corporations that issued stocks (equity shares) or bonds or other debentures on public securities markets. Provided material information to investors. This was the birth of the modern prospectus and IPO process. “Sunlight is the best disinfectant.”

1934 – Securities Exchange Act

Created the Securities and Exchange Commission and authorized it for rule making and enforcement. Extended federal regulation and anti-fraud and manipulation prohibitions to trading in securities (i.e. the secondary market). Established system for self-regulation in the securities markets. Created continuous disclosure system for issuers whose securities traded on exchanges or over-the-counter. Expanded anti-fraud provisions.

1935 – Banking Act of 1935

Required state banks with $1 million in assets to join Federal Reserve System. Broadened powers of the Fed to regulate banks, created FOMC at Fed, established Board of Governors at Fed (which excluded the Comptroller of the Currency and the Secretary of Treasury).

1936 – Commodity Exchange Act

1940 – Investment Company Act

Regulates companies that primarily invest in other companies. Thus it covers Mutual Funds as one type of investment company. Designed to address abuses in system and to minimize conflicts of interest that arise within these types of companies. Established disclosure requirements: 1) registration of investment company; 2) transactions between that company and any affiliate (e.g. Morgan Stanley the asset manager and Morgan Stanley the broker-dealer); 3) purchase and sale of investment company shares; and 4) responsibilities of directors and trustees

1940 – Investment Advisors Act of 1940

Required certain investment advisors to register with the SEC. (An investment advisor is someone who advises for compensation others about investing.) A 1996 amendment limited the registration requirement to advisors with more than $25 million under management or work for registered investment company. Investment advisors are required report on : 1) record keeping; 2) contracts; 3) advertising; 4) custody of client funds and assets; and 5) proxy voting.

1956 – Bank Holding Company Act of 1956 (and 1970).

Douglas Amendment prevented bank holding companies from holding banks across state lines. (The Act was aimed at Bank of America.) Applies to holding companies with controlling interest in two or more banks. It prevented holding companies from controlling any other business than banks, and put these holding companies under the regulation/ supervision of the Fed. The 1970 amendment redefined holding company to that with controlling interest in only one bank, to stop Citibank from owning related non-bank businesses. Fed has since issued a list of non-banking activities that the holding can operate: mortgage lending, tax preparation, other financial services.

1974 – Commodity Futures Trading Commission Act of 1974.
Created the CFTC, an independent federal body that oversees all futures trading. Established self-regulation for exchanges, but required them to obtain CFTC approval for any regulatory changes or for the introduction of new futures or options on futures contracts. Required exchanges to have trading rules, contract terms and disciplinary procedures approved by the CFTC.

RECENT DEVELOPMENTS IN MARKET REGULATION

1980 – DIDMCA
Depository Institutions Deregulation and Monetary Control Act of 1980.
Ends prohibition of paying interest on demand deposits, and phases out Regulation Q as of March, 1986. S&Ls given new consumer lending powers & increased size of mortgage loans they are able to make to offset loss of .25 percent i rate advantage. Raised deposit insurance coverage from $40,000 to $100,000. The intention was to help thrifts compete with banks and mutual funds and eurodollar deposits.

1982 – "Garn-St Germain" Depository Institutions Act of 1982
Geared towards banks and thrifts. Provided greater flexibility to federal bank regulators in dealing with troubled banks and thrifts. Expanded the ability of thrifts to offer a wider array of liabilities such as federally insured NOW and Super-NOW accounts. Also allowed them new powers to make more commercial loans in new areas. It allowed banks to merge with troubled thrifts across state lines.

Together DIDMCA and DIA acts gave federally chartered thrifts a wider range of investments (assets) and financial products (transactions accounts). They gains more powers to determine the interest rates on their deposits. (Rates were finally dereg. by March 1986.) It also the Depository Inst.s Deregulation Committee the authority to create money market deposit accounts (OCDs).

1986 – Tax Reform Act of 1986
Reduced incentives for thrifts to hold mortgage assets. These provisions decreased from 82% to 60% of total assets needed to qualify as a thrift. It also reduced the percentage of income that could be sheltered as bad-debt reserves. (Thus reducing incentives to hold reserves.)

1987 – Competitive Equality in Banking Act

This bill, amongst other things, exempted the parent holding corporation of an industrial loan banks (industrial loan companies) from consolidated supervision and regulation under the Bank Holding Company Act.

1987 – FSLIC Recapitalization

Funded new capital for the Federal Savings and Loan Insurance Corporation's deposit insurance fund. In order to pay for rising costs of losses of closing thrifts, bill set up FICO to issue bonds to supplement insurance premiums, asset sales, and asset income. Interest on bonds would be paid back with insurance premiums from FSLIC and later SAIF, and the principle would be covered with purchases of zero coupon Treasury bonds.

1989 – Financial Institutions Reform, Recovery, and Enforcement Act of 1989

FIRREA promoted the acquisition of thrifts by bank holding companies. Exempted bank holding companies from limits on branching in enable these purchases. Abolished the FHLBB (Federal Home Loan Bank Board) and created the Resolution Trust Corporation (RTC), Office of Thrift Supervision (OTS) and new deposit insurance funds for thrifts and savings associations (SAIF). Allowed thrifts to offer demand deposits to businesses. Limited commercial real estate lending to 400% of capital. Applied national bank regulations on limits to loans to one borrower to thrifts.

1993 – Rule 35 – "Swaps Rules" – to the Commodity Exchange Act

Chair of CFTC Wendy Gramm (appointed by President George H.W. Bush, and wife of Phil Gramm) wrote rule during in last weeks in office that "exempted" over-the-counter derivatives such as swaps from most of Commodity Exchange Act. Nonetheless Rule 35 did not exempt these derivatives from anti-fraud and manipulation authority.

1993 – Resolution Trust Corporation Completion Act of 1993

Terminates RTC in 1995, provides final funding for RTC and additional funding for SAIF. Also contained reformed of RTC management practices.

1994 – Interstate Banking Act of 1994

Permitted interstate bank holding companies and interstate branching, thus largely overturning the McFadden Act and its subsequent amendments.

1995 –Private Securities Litigation Reform Act ("PSLRA")

The Act made it more difficult for people harmed by acts of securities fraud or manipulation to sue for the recovery of damages. imposes strict pleading standards and stays discovery during the pendency of a motion to dismiss. This encourages plaintiffs' lawyers to focus on inferences of fraudulent intent and facts they can obtain without discovery, seeking out competitors, disgruntled former employees, and dissatisfied customers or suppliers. The Act did create a "safe harbor" for forward looking statements so that corporations and their management could not be sued for projections that did not come true.

1999 – Gramm-Leach-Bliley Act
Rolled back Glass-Steagall Act to allow bank holding companies and financial holding companies to own both commercial banking firms and securities firms (as well as insurance companies). Maintained the regulation of bank holding companies by the Fed, and created financial holding companies and made the SEC their regulator. Formalized functional regulation whereby federal financial regulators' authority not defined simply by type of institution but the type of activities within the institution. Reaffirmed the McCarran-Ferguson Act preventing the federal regulation of insurance and setting state licensing of insurance activities. Prohibits national banks and their subsidiaries from underwriting insurance – with some exceptions. Prohibits national banks from offering title insurance or annuities.

2000 – Commodity Futures Modernization Act of 2000 (CMFA)
Deregulated over-the-counter (OTC) derivatives trading by "excluding" or "exempting" them from coverage of the Commodity Exchange Act. This lifted anti-fraud and anti-manipulation authority from these derivatives markets. Also reduced the regulation and especially the transparency of exchange traded futures and options. Legalized single stock futures.

Regulatory Authorities in the Financial Sector

Federal

U.S. Congress (constitutional authority, write statutes and exercises oversight)

* Five federal agencies oversee US banks, thirsts or in general depository institutions.

Federal Reserve Board of Governors (Fed)

Created in 1913 to conduct monetary policy, supervise banking institutions, maintain the stability of the financial system, and provide financial services to the government.

Oversees 5,863 Bank Holding Companies

Oversees 919 State chartered banks that are members of Federal Reserve system

Federal Reserve Banks (12)

Office of Comptroller of the Currency (OCC)

Handles nationally chartered banks (it issues their charters). Created by National Bank Act of 1864 to charter, supervise, and regulate banks as well as be responsible for national currency. Conflict with Fed after its creation in 1913 because of overlapping authority. Today, the OCC: 1) charters national banks; 2) supervises member (national + state member) banks and enforces McFadden Act (interstate banking); 3) approves mergers and branches. Has permanent offices in London to oversee foreign banks.

Office of Thrift Supervision (OTS, formerly FSLIC)

Created by FIRREA. A bureau of Treasury. Regulation and supervision successor to Fed. Home Loan Bank Board (FHLBB) over state and federal thrifts, and their holding companies. The Regulatory and supervisory component of former FSLIC.

National Credit Union Administration (NCUA)

An independent federal agency that charters and supervises federal credit unions, and it operates the federal credit union share insurance fund.

Regulates and supervises 9,128 credit unions.

Federal Deposit Insurance Corporation (FDIC)

Created as an independent agency in 1933 by Glass-Steagall Act.

It insures deposits, monitors risk to bank insurance fund, and limits the effects on overall economy when a depository institution fails.

It also handles state chartered banks that are not members of the Federal Reserve system.

The FDIC has taken over FSLIC's role as provider of deposit insurance to thrifts. In doing so it administers two deposit insurance funds: the Band Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF).

Presently, the FDIC oversees 5,272 institutions – about half of all banking institutions, and provides deposit insurance to 8,854 banks.

Office of Federal Housing Enterprise Oversight (OFHEO)

Oversees Fannie Mae and Freddie Mac.

Public Accounting Oversight Board

Created by Sarbanes-Oxley Act in 2002 to oversee public accounting standards.

Pension Benefit Guarantee Commission (PBGC)

Federal Housing Finance Board

Formerly the Federal Home Loan Bank Board.

Federal Housing Finance Board is responsible for supervising Federal Home Loan Banks. FHFB governed by a five-member board including the Sec. of HUD, & 4 other presidential appointees w/ Senate confirm.; 7 yr. terms.; chair appointed by President.

Presidents Working Group on Financial Markets – only power to recommend

Formed under the Reagan administration, in the wake of the Oct '87 crash, by Executive Order 12631 on March 18, 1988. Comprised of Sec. Treas., the Fed. Res. Chair, the SEC Chair, and the CFTC Chair.

Securities and Exchange Commission (SEC)

Regulation and supervision of securities industry. Created by Securities Exchange Act of 1934 which also established disclosure rules for companies issuing stock. The SEC abolished the system of fixed commission on May 1, 1975.

Commodity Futures Trading Commission (CFTC)

Commodity Futures Trading Commission. First federal law regulating futures traded passed was Grain Futures Act of 1923. It was amended to become the Commodity Exchange Act of 1936, which evolved into the Commodity Futures Trading Commission Act of 1974. That act created the CFTC, an independent federal body that oversees all futures trading.

Federal Financial Institutions Examination Council

A FIRREA creation.

Resolution Trust Corporation - RTC (Now defunct, formerly an agency under Treasury)

Resolution Trust Corporation Oversight Board: 5 members (Sec. of Treasury, Chair of Fed Board, Sec. of Housing & Urban Dev., & 2 independent members w/ Pres. appt. & Senate Confirmation). Sets guidelines for & releases funds to RTC.

Resolution Trust Corp (RTC): resolves failed thrifts by sale/liquidation. Operations administered by FDIC.

State

Securities Commissions

Attorneys General (enforcement activities that lead to regulatory changes, e.g. global settlement)

Banking regulatory agencies

State insurance regulators

Private Sector – Self Regulatory Organizations

National Association of Security Dealers (NASD)

Futures Industry Association (FIA)

National Futures Association (NFA)

Exchanges (numerous securities and futures exchanges)

- NYSE
- NASDAQ

American Stock Exchange
Philadelphia Stock Exchange
Pacific Stock Exchange
Chicago Board of Trade
Chicago Mercantile Exchange
New York Mercantile Exchange
New York Board of Trade
Chicago Board Options Exchange
Inter-Continental Exchange (ICE)
Kansas City Board of Trade
Minneapolis Grain Exchange

✻

A more printer friendly version of this Brief is available at:

www.financialpolicy.org/dscprimers.htm

GO TO Financial Policy Forum's website:

www.financialpolicy.org