

# Funds

## E-ALERT

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### New Systemic Risk Legislation

#### CONGRESS MOVES FORWARD

Within the next few weeks, we expect key Committees in both the House and Senate to begin consideration of several pieces of new systemic risk legislation.

Chairman Frank of the House Financial Services Committee wants to start marking up proposed legislation as early as May, and hopes to complete action in the House before the August recess. He has indicated that the plan for his Committee is to consider first legislation creating new federal systemic risk resolution authority to cover "nonbank" financial firms – that is, firms that are not already subject to the FDIC's resolution authority over insured depository institutions. Firms that could potentially be covered include, among others, complex financial institutions, private investment funds such as hedge funds and private equity funds, and large insurance companies. After addressing new federal systemic risk resolution authority, Chairman Frank plans to turn to legislation creating and empowering a new systemic risk regulator.

In the Senate, Chairman Dodd of the Senate Banking Committee has indicated that he wants to address the overhaul of all financial services regulation – including the creation of new system risk resolution authority and a new systemic risk regulator – in a single, comprehensive bill, as opposed to Chairman Frank's piecemeal approach. However, Chairman Dodd has indicated his agreement with Chairman Frank on one essential point – the need for Congress to place such legislation on the President's desk for signature before the end of this year. As a result, we currently expect work on new systemic risk legislation to begin with hearings following Congress' return from its Easter recess.

#### KEY ISSUES

We anticipate that proposed legislation creating new systemic risk resolution authority and a new systemic risk regulator will raise a number of critical issues for affected financial firms.<sup>1</sup> Among the key issues already emerging are the following:

- How the legislation will define the categories of financial firms covered by the systemic risk authority, for example based on characteristics such as firm size, leverage, reliance on short-term funding, or importance as a source of credit and liquidity.
- The scope of discretion given federal regulators to declare that a firm poses systemic risk and therefore is subject to new systemic risk regulation.

<sup>1</sup> Indeed, some of these issues are already apparent in the draft systemic risk resolution authority legislation that Treasury released in late March in conjunction with Secretary Geithner's testimony before the House Financial Services Committee on the Administration's proposed framework for financial regulatory reform.

- For investment funds, whether the legislation will differentiate amongst types of funds based on characteristics such as the size of the investment fund and its potential for posing systemic risk, whether it is a hedge fund, private equity fund or venture capital fund, whether significant leverage exists at the fund level, and in the case of private equity funds, the type of fund in question (for example, direct funds vs. funds-of-funds/secondary funds; buyout funds vs. venture capital funds).
- The scope of federal regulators' authority to prescribe individually tailored regulatory requirements for systemically important firms in areas such as capital, leverage and risk-management – and the scope of federal regulators' authority to enforce such requirements.
- The interaction of federal regulators' systemic risk regulation with other existing regulation (for example, by the SEC) and other laws (for example, the Bankruptcy Code).
- The scope of discretion given to federal regulators to declare that a firm is in danger of failure and that its failure poses a systemic risk warranting federal intervention (whether in the form of federal assistance, or a federal conservatorship or receivership, or some combination of such actions).
- How the cost of a new systemic resolution process will be assessed against firms subject to its reach, including whether there will be new FDIC-style assessments on a some universe of firms and, if so, how such assessments will be apportioned.
- The extent to which federal regulators, in the exercise of systemic risk resolution authority, will be allowed to resolve the claims of creditors and other claimants – and how.

#### WHAT YOU CAN DO

We believe that private equity firms and hedge funds have a significant stake in the evolution of the proposed systemic risk legislation. It is very possible that investment funds may become subject to such regulation and to the potentially broad "resolution" powers granted to the new authority. Further, the manner in which certain issues are resolved in the context of systemic risk regulation legislation (for example, which entities are subject to regulation or "resolution," and which are not) may well influence other near-term legislation affecting the investment fund industry, including the proposed registration of investment managers and investment funds.

Firms potentially affected by the new systemic risk legislation will want to consider a number of steps relating to the near-term legislative process, including:

- At a minimum, keeping abreast of key developments in the legislative process over the next 3-6 months so that they can understand the implications of proposed legislation for their businesses and evaluate what efforts are being made by other firms/industry groups in the legislative process. Many firms are designating one senior-level person (often the general counsel or other senior manager) to be their "point person" for this monitoring process.
- Reaching out to peer firms and other affected businesses to explore opportunities for collective action.
- Considering how to communicate firm and industry views on proposed legislation to key Members of Congress and their staffs (for example, individually, through ad hoc groups or through trade associations).
- Educating key Members of Congress and their staffs on the nature of their businesses and, for investment funds, relevant distinctions amongst various types of investment

funds – including where their businesses present legitimate systemic risk issues or other appropriate concerns, and where they do not.

- Developing strategies to oppose, or reshape, troublesome aspects of proposed legislation – and ensuring that such strategies are effectively implemented.

Our firm has been deeply involved in virtually all aspects of the U.S. Government's response to the current economic crisis. With decades of experience in assisting clients with critical regulatory and legislative issues in Washington and particularly with strong expertise in regulatory and legislative affairs touching the financial services industry, we are well positioned to assist clients in connection with the forthcoming systemic risk legislation.

If you would like to discuss such legislation and our capabilities to assist you in the upcoming legislative process, please feel free to contact:

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