Chapter 2

The Impact of Government Policy and Regulation on the Financial Services Industry

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Contents from the textbook Peter & Sylvia

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- Key financial US laws
- The Major Banking Laws
- Organizational structure of FRS
- OMO
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Introduction

- Regulations enforced by federal and state agencies oversee the operations, service offerings, performance and expansion of most financial service firms

Basic concepts

- Regulation:

  They are rules that help the government to oversee the behavior and performance of financial firms

Basic concepts

- Chartering:

  They are rules that

Basic concepts

- Dual system in the US:

  A system in which both federal and state governments are involved in chartering, supervising, and examining selected financial – service companies through regulation

Basic concepts

- Deregulation:

  It is a new and powerful force reshaping financial firms and their regulators today to encourage increased competition and greater discipline in the marketplace.

Basic concepts

- Reregulation:

  - They are stressing new tougher government rules

  - The Dodd-Frank Regulatory Reform Act allows new federal dept. set up to protect consumers of financial services and provide cushions against global risk

Basic concepts

- Systemic risk:

  - The risk relates to the entire market, also called un-diversifiable risk or market risk

Roles of financial service institutions

- Protecting and attracting the public's savings
- Providing credit to a wide range of borrowers
- Creating money to serve as the principal medium of exchange in a modern economy

Roles of the central bank

- Regulates money and credit conditions
- Stabilize the economy and financial system
- Conduct monetary policy using such tools as:
- Open market operations
- Short-term loans
- Legal reserve requirements

The key regulators of banks

- Federal Deposit Insurance Corp. (FDIC): regulates state-chartered banks that are not members of the FRS
- Federal Reserve System (FRS): oversee state-chartered banks joining FRS
- Office of the Controller of the Currency (OCC): examines national banks

Pros and cons of strict rules

- Tore down the regulatory walls separating banking from security trading and underwriting
- Allow these different types of financial firms to acquire each other
- Increase competition

The key financial U.S laws

- The National Bank Act
- The Glass-Steagall Act (separated commercial and investment banking)
- The Riegle-Neal Interstate Banking and Branching Efficiency Act (bank firms can branch across state lines)
- The Gramm-Leach Bliley Act (restrictions against banks, security, and insurance firms affiliating with each other)
- The Sarbanes-Oxley Accounting Standards Act (imposing financial accounting practices)

The key financial U.S laws

- The Bank Secrecy and USA Patriot Acts
- The Check 21 Act (conversion of paper checks into electronically transferable payment items)
- The Fair and Accurate Credit Transactions Act (greater public access to credit bureau reports)
- The Dodd-Frank Regulatory Reform Act of 2010 (a broad range of new government rules to deal with systemic risk)

The Major Banking Laws

- National Currency and Bank Acts (1863-64)

The Major Banking Laws

- The Federal Reserve Act (1913)

The Major Banking Laws

- The Banking Act of 1993 (Glass-Steagall)
  - 1929-1933: > 9000 banks failed
  - Stricter rules and regulations needed
  - Separate commercial banking from investment banking and insurance

The Major Banking Laws

- The Banking Act of 1993 (Glass-Steagall)
- FDIC established to guarantee the public's deposits to a maximum amount ($2500, now up to $250,000)

The Major Banking Laws

- The FDIC Improvement Act (1991)
- Permit FDIC to borrow from the Treasury to remain solvent
- In 1993, FDIC implemented new deposit insurance premiums because most depositors do not carefully monitor bank risk

The Major Banking Laws

- Social responsibility laws
- In 1968, the Congress passed the Consumer Credit Protection Act
- Before and after 1990s, *interstate bank expansion* resolved

The Riegle-Neal Interstate Banking Law (1994)

- Adequately capitalized and managed holding companies can acquire banks anywhere in the US
- No single banking company can control more than 10% of nationwide deposits or more than 30% of deposits in a state

The 1999 Gramm Leach Bliley Act

- Tore down the regulatory walls separating banking from security trading and underwriting
- Allow these different types of financial firms to acquire each other
- Increase competition

The USA Patriot and Bank Secrecy Acts

- The Patriot Act 2011 made amendments to the Bank Secrecy Act 1970 that required selected financial firms to report “suspicious” activity on the part of their customers.

Discussion

- Advantages /Disadv of deregulation
- Advantages/Disadv of reregulation

The Sarbanes-Oxley Accounting Standards Act 2002

- Publishing misleading information about financial performance of publicly owned corporations is prohibited

The FACT Act 2003

- The Fair and Accurate Credit Transactions Act passed to help individuals victimized by ID theft to file a theft report and required the nation's credit bureaus to help victims resolve the problem.

The Check 21 Act

- Reducing the need for depositors to transport paper checks across the country : costly and risky
- Substitute check can be transported electronically
- Promote electronic payment system, away from writing and processing more checks

The 2005 Federal Deposit Insurance Reform Act

- Expand the safety net protecting the retirement savings of individual depositors
- Allow federal regulators to periodically adjust deposit insurance coverage upward to fight inflation
- Stabilize the flow of premium payments

The 2008 Emergency Economic Stabilization Act

During the global credit crisis, The Act passed

- Allow the US Treasury the means to purchase up to $700 b in “bad” assets (troubled mortgages and consumer loans)
- Permit the government to inject additional capital into banks and other qualified lenders

The Major Banking Laws

- US banks' capital requirements based on the terms of the FDIC Improvement Act 1991 and the intl. capital agreements known as Basel I, II, and III began in 1988 b.t the US and 12 other leading nations in Europe and Asia, imposing the same capital rules on all global major banks

The Central Banking system

- In addition to law, regulation, the central bank shapes the behavior and performance of financial firms through money and credit policies
- Ex: FRS, ECB, BOJ, and PBC

Organizational structure of the FRS

- Board of Governors: <= 7 persons, selected by the US president, terms <= 14 years. This is the center of authority and decision making.
- Set reserve requirements on deposits
- Approve all changes in the discount rates, or open market policy
- Regulates and supervises activities of 12 reserve banks

Organizational structure of the FRS

- Federal Open Market Committee (FOMC): set policies that guide the conduct of OMO
- FRS divided into 12 districts, so, 12 FR banks offer depository institutions:
- Wire transfers of funds
- Safe-keeping securities
- Issuing new securities from the US Treasury
- Loans by "Discount Window"
- Clearing and collecting checks….

Organizational structure of the FRS

- Designated member banks: all banks chartered by national banks and few state banks willing to conform to the Fed's regulation

The Central Bank's Principal Task

- Conduct money and credit policy to promote sustainable economic growth and avoid severe inflation by:
- Legal reserves of the banking
- Interest rates charged on loans
- Relative currency values in the global foreign exchange markets

The Central Bank's Principal Task

- Legal reserves of the banking:

  Consist of cash depository institution keep in their vaults and deposits these institutions hold in their reserve accounts at the district FR banks.

The Central Bank's Principal Task

Interest rates:

- Higher to reduce lending
- Lower to stimulate business and consumer borrowing

Currency values

- Influenced by levels of interest rates

The Open Market Policy Tool of Central banking (OMO)

- One of 3 main tools to affect the legal reserves, rates and currency values
- U.S T bills, bonds, notes and selected federal agency securities

The Open Market Policy Tool of Central banking (OMO)

- Central bank sales of securities tend to decrease the growth of deposits and loans
- Central bank purchases of securities tend to increase the growth of deposits and loans

Other Central Bank Policy Tools

- Short-term loans for depository institutions with discount rate
- Changes in reserve requirements (very infrequently)
- Moral suasion such as press releases urging the public to cooperate with central bank to strengthen the economy

Other Central Bank Policy Tools

- 2 new policy tools in 2007-2008 of FRS:
- Term Auction Facility (TAF)
- Term Securities Lending Facility (TSLF)

to make loans to depository institutions and securities dealers for about 1 month to increase liquidity and expand credit

Individual assignments & report

- Choose 1 commercial bank (preferred foreign bank branch) in Viet Nam: ANZ, HSBC, Commonwealth, Citibank, Tokyo Mitsubishi bank,…
- Introduction
- Advantages and disadvantages of products and services
- Analyze financial data from financial statements of the bank
- What are Risk types, Risk management and investment strategies of the bank
- Services Pricing and premium policies of the bank
- Conclusion

Individual assignments & report

- All assignments should be typed and double-spaced with 11-point font, and must be submitted in both soft and hard copy in about 15-20 pages. A deduction of 10% of the assignment mark will be applied for each day of late submission; The deadline for individual assignment submission is noticed in the syllabus schedule.

Seminar on Banking

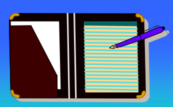
- Groups of students will be required to complete a presentation (using ppt) on Fri 25 and written report about one issue in commercial bank management relating to the chapter of each session, ALL of which will contribute towards the final assessment. NO SUPPLEMENTARY PRESENTATIONS WILL BE OFFERED.
- Plan what you are going to write

Seminar on Banking

- Based on topics of studied chapters, Group presentation in class room
- All assignments should be typed and double-spaced with 11-point font, and must be submitted in both soft and hard copy (cover page, student names). A deduction of 10% of the assignment mark will be applied for each day of late submission
- Evaluation will be based on both presentation (10%) and written report (15%)

Summary

- Financial firms need fully aware of both government regulation and central bank monetary policy on their particular institutions



Multiple Choice Question

1. A central bank's job is monetary policy:

a. True

b. False

Multiple Choice Question

2. Legal reserves consist of assets held by a depository institution meeting the reserve requirement by a central bank:

a. True

b. False

MCQ-Answers

1. A
2. A

Terminologies

- Cushion (n): cái đệm
- Testify (v): xác nhận
- Victimized: lừa bịp