Non-Bank Companies Poised for Fed Scrutiny on Systemic Risk

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By Ian Katz
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It has the makings of a Wall Street parlor game: Guess which firms will be designated for Federal Reserve oversight because they could pose a risk to U.S. financial stability.

A council of regulators, which met for the first time Oct. 1, will review non-bank financial companies for possible inclusion under the Fed's regulatory umbrella, taking into account everything from size and debt to hidden liabilities, Bloomberg Businessweek reports in its Oct. 11 issue.

U.S. bank holding companies with more than $50 billion in assets -- about 35 in all, including JPMorgan Chase & Co. and Goldman Sachs Group Inc. -- are automatically included.

A large number of hedge funds, private equity firms, and derivatives clearinghouses could also be considered. GE Capital, General Electric's financial arm, has said it expects to be included. Its operations include the biggest issuer of store- brand credit cards in the U.S., aircraft leasing, small-business lending, and commercial real estate.

American International Group Inc., which during the 2008 crisis became the symbol of a lightly regulated conglomerate and an inspiration for the new Financial Stability Oversight Council, could also be included.

Geithner Suggested

Treasury Secretary Timothy F. Geithner, the council's chairman, suggested both companies would be on the list when he said on Sept. 30 that the Dodd-Frank law overhauling financial rules imposes stricter oversight on entities "that are banks in all but name, whether you call them investment banks, or AIG, or GE Capital." Such firms may be forced to "run with a much more conservative, prudent leverage and funding mix," he said.

Atlanta-based Intercontinental Exchange Inc., which owns a derivatives trade-processing operation, and New York's Depository Trust & Clearing Corp., which completes stock trades, may be tapped, say former Treasury officials, regulatory lawyers, and analysts.

Citadel LLC, the Chicago-based hedge fund that is the biggest shareholder in E*Trade Financial Corp. and has a small investment bank, could come under scrutiny. So could Blackstone Group LP, the world's largest buyout firm, they say.

Companies that consumers heavily depend on, including insurers and credit-card companies, might also come under heightened inspection. Though they aren't exempt, mutual funds may escape review because they typically take on less risk than hedge funds. Citadel, AIG, Blackstone, and the clearing firms declined to comment.

Cost or Benefit

It's unclear whether Fed supervision will be a cost or a benefit. "Investors may perceive you as being so carefully watched that you're a safer investment, and that reduces your cost of funds," says Wayne Abernathy, an executive vice president at the American Bankers Association, a lobbying group based in Washington, and former Treasury official. "The downside is a certain amount of new, heavy regulatory burden comes with it."

Rules about how the designations will be made are due in spring. A 30-day public comment period on the rules began Oct. 6. It may be a challenge for the council to ignore public opinion when deciding who falls under the new regime.

"There's going to be a lot of controversy once they start doing this, and the decisions will be very difficult to defend," says Hal S. Scott, a Harvard Law School professor. "When the first one is designated," he says, "everyone's going to ask why them and not us, or why us and not them."