Dodd-Frank Wall Street Reform and Consumer Protection Act

July 2010

CLIFFORD CHANCE

Contents

Principal Defined Terms

Defined	Term
Advisers Act	Investment Adviser's Act of 1940
AUM	Assets Under Management
BCFP	Bureau of Consumer Financial Protection
BDC	Business Development Company
BHC	Bank Holding Company
BHCA	Bank Holding Company Act
CDS	Credit Default Swaps
CFTC	Commodity Futures Trading Commission
DFMU	Designated Financial Market Utilities
Exchange Act or 1934 Act	Securities Exchange Act of 1934
FDIA	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FHC	Financial Holding Company
FHFA	Federal Housing Finance Agency
Financial Crisis Fund	Financial Crisis Special Assessment Fund
Financial Oversight Council	Council of Inspectors General On Financial Oversight
FINRA	Financial Industry Regulatory Authority
FIO	Federal Insurance Office
FRA	Federal Reserve Act
FRB	Federal Reserve Board or Board of the Federal Reserve
GAO	Government Accountability Office
GASB	Government Accounting Standards Board
ILC	Industrial Loan Company
IMF	International Monetary Fund
Investment Company Act or 1940 Act	Investment Company Act of 1940
LIBHC	Large, Interconnected Bank Holding Company
Mortgage Reform Act	Mortgage Reform and Anti-Predatory Lending Act
MSRB	Municipal Securities Rulemaking Board
NAIC	National Association of Insurance Commissioners
NBFC	Nonbank Financial Company
NRSRO	Nationally Recognized Statistical Rating Organization
OCC	Office of the Comptroller of the Currency
OFR	Office of Financial Research
OIA	Office of the Investor Advocate
OLA	Orderly Liquidation Authority
OTC	Over-the-Counter
OTS	Office of Thrift Supervision
Oversight Council or Council	Financial Stability Oversight Council
PCAOB	Public Company Accounting Oversight Board
QFC	Qualified Financial Contract
SEC	Securities and Exchange Commission
Securities Act or 1933 Act	Securities Act of 1933
SEF	Swap Execution Facility
SIPA	Securities Investor Protection Act of 1970
SIPC	Securities Investor Protection Corporation
SLHC	Savings and Loan Holding Company
SPV	Special Purpose Vehicle
SRO	Self-regulatory Organization
TAGP	Transaction Account Guarantee Program
TARP	Troubled Assets Relief Program

Selected Highlights

Title I:

Financial Stability Oversight Council

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") provides for the establishment of a Financial Stability Oversight Council (the "Council") comprised of the heads of the financial regulatory agencies. The Council is generally tasked with identifying and responding to systemic risks and its duties include, among other things: (i) designating systemically important "nonbank financial companies"; (ii) making recommendations concerning the establishment of heightened regulatory capital standards, leverage, liquidity, contingent capital, resolution plans, concentration limits, short term debt limits, enhanced disclosures and overall risk management standards for systemically important bank holding companies and "nonbank financial companies;" (iii) collection of financial information for assessing systemic risks; and (iv) making recommendations to member agencies concerning supervisory standards, priorities, and principles.

A nonbank financial company that the Council determines could pose a threat to the financial stability of the United States ("NBFC") is required to register with, and is subject to supervisory and prudential standards imposed by, the Federal Reserve. Large, interconnected bank holding companies ("LIBHCs") are also generally treated as systemically important.

If the Federal Reserve determines that a bank holding company ("BHC") with total consolidated assets of $50 billion or more or NBFC poses a grave danger to the financial stability of the United States, the Federal Reserve, upon affirmative vote of not less than 2/3 of the members of the Council, shall require the subject company to: (i) terminate activities; (ii) impose conditions on the conduct of activities; (iii) limit any expansion; or (iv) dispose of assets or off-balance-sheet items.

Office of Financial Research

An Office of Financial Research is established within the Treasury Department to support the Council and the financial regulatory agencies by, among other things: (i) collecting data; (ii) standardizing the types of data reported and collected; and (iii) developing tools for risk management and monitoring.

Federal Reserve Authority Over NBFCs and LIBHCs

The Federal Reserve may require reports and examine any NBFC and its subsidiaries to assess: (i) the nature of the operations and the financial condition of the company; (ii) the risk the company may pose to the financial system and its systems for monitoring and controlling such risks; and (iii) compliance with regulatory requirements. If the Federal Reserve determines that an NBFC is not in compliance with Federal Reserve regulations or poses a threat to financial stability, the Federal Reserve may recommend an enforcement action to the NBFC's primary financial regulator and, if the primary financial regulator does not take an enforcement action acceptable to the Federal Reserve, the Federal Reserve will have a back-up authority to itself impose such an enforcement action.

The Federal Reserve is required, on its own or pursuant to recommendations by the Council, to establish prudential standards and disclosure requirements to NBFCs and BHCs with total consolidated assets of $50 billion or more (also referred to herein as "LIBHCs") that are more stringent than the requirements applicable to BHCs and that may increase in stringency depending on a number of factors. Such standards include: (i) risk-based capital requirements; (ii) leverage limits; (iii) liquidity requirements; (iv) overall risk management requirements; (v) resolution plan and credit exposure requirements; and (vi) concentration limits. Such prudential standards may also include: (i) contingent capital requirements; (ii) enhanced public disclosures; (iii) short-term debt limits; and (iv) such other prudential standards that the Federal Reserve determines are appropriate.

The Act imposes a minimum capital requirement that prohibits depository institution holding companies to include qualifying trust preferred securities in Tier I capital. The inclusion in Tier I capital of such instruments issued prior to May 19, 2010 will be phased out over a 3 year period commencing on January 1, 2013. Depository institution holding companies with total consolidated assets of less than $15 billion will be able to continue to include in Tier I capital trust preferred securities issued prior to May 19, 2010.

Title II: Orderly Liquidation Authority

The Act creates a new regime for liquidation of nonbank financial companies whose potential collapse may jeopardize financial stability in the United States. Under the new regime, generally modeled after the existing framework for failed insured depository institutions, the Federal Deposit Insurance Corporation (the "FDIC") is authorized to seize exclusive control of a failing nonbank financial company and administer its liquidation in accordance with the Act's provisions.

Title III: Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

Abolishment of the OTS

One year after the date of enactment, the powers and duties of the Office of Thrift Supervision ("OTS") will be transferred to the Federal Reserve, the OCC, and the FDIC. Effective 90 days after the transfer date the OTS will be abolished. The Act does not abolish, however, the Federal savings association charter. Within 18 months of enactment of the Act, the Government Accountability Office ("GAO") will conduct a study to determine whether it is necessary to eliminate the exemption from the BHCA definition of a "bank" for such institutions.

Deposit Insurance Reforms

The FDIC generally defines the term "assessment base" as the amount equal to the average consolidated assets of the insured depository institution during the assessment period minus the average tangible equity of the insured depository institution during the assessment period. The Act permanently increases the standard maximum deposit insurance amount from $100,000 to $250,000. The Act extends until January 1, 2013 the FDIC's Transaction Account Guarantee Program.

Title IV: Regulation of Advisers to Hedge Funds and Others

Title IV amends several provisions of the Investment Advisers Act of 1940, most significantly by eliminating the private adviser exemption from registration under such Act. Title IV provides certain new exemptions from registration, including for advisers to private funds with AUM under $150 million and venture capital funds regardless of AUM. Title IV would leave the definition of "venture capital fund" to future rulemaking and also permits the SEC to determine the registration requirements applicable to the advisers of "mid-sized" private funds based on the level of systemic risk posed by such funds.

Title V: Insurance

Subtitle A seeks to improve the system of insurance regulation by focusing on mitigation of systemic risk with respect to insurance and bridging gaps in insurance regulation. The title seeks to accomplish this by: (i) establishing the Federal Insurance Office; and (ii) facilitating international coordination of insurance regulation through prudential measures.

Subtitle B seeks to reform insurance regulation of nonadmitted insurance and reinsurance through setting uniform measures, streamlining standards, and clarifying the governing State law in the reporting, payment, and allocation of premium taxes, licensing surplus lines brokers and regulating credit for reinsurance and reinsurer solvency.

Title VI: Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

Moratorium and Study On ILCs, Credit Card Banks and Certain Trust Companies

The Act imposes a three year moratorium on approval of FDIC insurance applications and change in control applications by industrial loan companies ("ILCs"), credit card banks, and certain trust companies ("trust banks") that are directly or indirectly owned or controlled by a commercial firm. ILCs, credit card banks, trust banks, and savings associations are currently exempted from the definition of a "bank" under the BHCA and their holding companies are not regulated as BHCs. Within 18 months of enactment of the Act, the Government Accountability Office ("GAO") will conduct a study to determine whether it is necessary to eliminate the exemption from the BHCA definition of a "bank" for such institutions.

Reports and Examinations of Functionally Regulated Subsidiaries

The Act generally expands the examination powers of the Federal Reserve with respect to functionally regulated subsidiaries. The Act also eliminates the current limitations on the rulemaking, prudential, supervisory, and enforcement authority of the Federal Reserve with respect to functionally regulated subsidiaries of BHCs.

Supervision of Non-Functionally-Regulated Holding Company Subsidiaries

The Act provides that the Federal Reserve shall examine the activities of a non-depository institution subsidiary (other than a functionally regulated subsidiary or a subsidiary of a depository institution) in the same manner, subject to the same standards, and with the same frequency as required if such activities were conducted in the lead insured depository institution. The appropriate Federal banking agency for the lead depository institution of a depository institution holding company shall have back-up examination and enforcement authority with respect to such subsidiaries.

Well Managed And Well Capitalized Requirement for FHCs And Certain Transactions

Currently, BHCs may qualify for FHC status that permits them to engage in an expanded range of financial activities if their depository institution subsidiaries are well capitalized and well managed. The Act requires the FHC itself to meet the well capitalized and well managed criteria. The Act also requires BHCs seeking to make interstate bank acquisitions to meet the well capitalized and well managed criteria.

Amendments to Inter-Affiliate Transaction Restrictions

The Act contains a number of amendments to Section 23A of the Federal Reserve Act ("FRA") governing transactions between a bank and its affiliates. Among other things, the Act subjects repurchase agreements to the collateralization requirements of Section 23A and applies the quantitative, qualitative, and collateral requirements of Section 23A to securities borrowing and lending transactions and derivative transactions with an affiliate to the extent that such transactions cause the bank or its subsidiaries to have a credit exposure to the affiliate.

Lending Limits Coverage

Currently, the total loans and extensions of credit by a national bank to a person are subject to certain limits. The Act expands the definition of "loans and extensions of credit" to include credit exposures to a person arising out of derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions. The Act also provides that an insured State bank may engage in a derivative transaction only if the relevant State's law with respect to lending limits takes into consideration credit exposure to derivative transactions.

Securities Firms Holding Companies

The Act repeals the elective investment bank holding company regulatory framework, pursuant to which investment banks were able to elect to be supervised on consolidated basis by the SEC pursuant to the US Securities Exchange Act of 1934, and institutes an elective regulatory framework for "securities holding companies" under the authority of the Federal Reserve.

A securities holding company that is required by a foreign regulator to be subject to comprehensive consolidated supervision is able to register with the Federal Reserve to become a "supervised securities holding company." A supervised securities holding company is subject to the provisions of the BHCA, other than section 4 of the Act, and is fully subject to the Federal Reserve's supervision and regulation powers under the BHCA.

The Volcker Rule

The Volcker Rule generally prohibits "proprietary trading" and "sponsoring" or acquiring of any ownership interest in "private equity funds" or "hedge funds" by insured depository institutions, insured depository institution holding companies, BHCs, and their affiliates (collectively "banking entities"). NBFCs engaged in such activities are subject to certain additional capital requirements and quantitative limits.

Subject to any restrictions or limitations that the appropriate Federal banking agencies, the SEC, and the CFTC may impose, the general prohibition on proprietary trading activities does not apply with respect to: (i) the trading of obligations of the United States, obligations of any state or political subdivision of a state, and obligations of or instruments issued by Ginnie Mae, Fannie Mae, or Freddie Mac; (ii) trading of securities and other instruments in connection with underwriting or market-making-related activities; (iii) risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings; (iv) trading on behalf of customers; (v) certain trading activities by regulated insurance companies; and (vi) trading activities conducted solely outside of the United States by companies that are not directly or indirectly controlled by a company organized under US law.

Subject to any restrictions or limitations that the appropriate Federal banking agencies, the SEC, and the CFTC may impose, the general prohibition on "sponsoring" or investing in "private equity funds" or "hedge funds" does not apply to: (i) investments in small business investment companies, as that term is defined in section 103 of the Small Business Investment Act of 1958; (ii) investments designed to promote the public welfare; (iii) an investment made solely outside the United States provided that the company making the investment or conducting the activity is not directly or indirectly owned or controlled by a company organized under US law and that no ownership interest in the target hedge fund or private equity fund is offered or sold to US residents; and (iii) organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund, provided that: (a) the fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, or investment advisory services provided by the banking entity or NBFC to customers; (b) the banking entity or NBFC does not acquire more than a de minimis ownership interest in the fund; (c) the banking entity or NBFC does not guarantee, assume, or otherwise insure the obligations of the fund; (d) the banking entity or NBFC does not share the same name or its variation with the fund; (e) no director or employee of the banking entity or NBFC has an ownership interest in the fund (except for directors or employees directly engaged in providing services to the fund); and (f) the banking entity or NBFC discloses to investors that any losses of the fund are borne solely by the investors and not by the banking entity.

A banking entity is able to make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers, provided that within a year of the establishment of the fund (with the possibility of two one-year extensions) the ownership interest of the banking entity in the fund shall be reduced through redemption, sale, or dilution to less than 3 percent of the total ownership interest in the fund. The aggregate investments by a banking entity in hedge funds or private equity funds may not exceed 3 percent of the Tier 1 capital of the banking entity.

Concentration Limits

Subject to recommendations by the Council, a financial company is not able to merge or consolidate with another company if the total consolidated liabilities of the acquiring company upon consummation of the transaction exceeds 10 percent of the aggregate consolidated liabilities of all financial companies as of the year end preceding the transaction. This limit does not apply to: (i) an acquisition of a bank in default or in danger of default or receiving FDIC assistance; or (ii) transaction that results only in de minimis increase of the liabilities of the financial company.

Title VII: Wall Street Transparency and Accountability

Title VII of the Act provides for significant reforms of the over the counter (OTC) derivatives market, grants significant authority to the SEC and the CFTC to regulate derivatives and market participants and requires clearing and exchange trading of most derivatives transactions.

Title VIII: Payment, Clearing, and Settlement Supervision

Title VIII is intended to reform transaction clearance and settlement provisions to mitigate systemic risk in the financial system and to promote financial stability. The Act seeks to accomplish this by: (i) designating certain entities and activities as systemically important; (ii) facilitating the creation of risk management standards; and (iii) providing regulators with increased examination, enforcement and information gathering authority. Designated entities are also granted access to the Fed's discount window.

Title IX: Investor Protections and Improvements to the Regulation of Securities

Title IX seeks to increase investor protections by, among other things, requiring the SEC to study and consider establishing a fiduciary standard of care for broker-dealers commensurate to that applicable to registered investment advisers. It also includes provisions: (i) establishing additional whistleblower protections; (ii) increasing the SEC's authority to seek collateral bars; (iii) requiring the SEC to submit annual reports on its regulatory activities; and (iv) strengthening aspects of corporate governance. Subtitle H significantly impacts the regulation of the municipal securities industry by, for example: (i) requiring municipal advisors (e.g., persons who advise municipal entities) to register with the SEC; (ii) expanding the authority of the Municipal Securities Rulemaking Board ("MSRB"); and (iii) creating an Office of Municipal Securities within the SEC to administer SEC rules regarding municipal securities and coordinate rulemaking and enforcement actions with the MSRB.

Subtitle C of Title IX: Improvements to the Regulation of Credit Rating Agencies

Subtitle C of Title IX of the Act contains credit rating agency provisions which seek to address the varied conflict of interest problems that Congress has determined arise in the governance of credit rating agencies and the issuance of credit ratings.

Subtitle D of Title IX: Improvements to the Asset-backed Securitization Process

Amendments to the Securities Exchange Act and the Securities Act included in Subtitle D of Title IX of the Act operate to: (i) introduce a new definition of "asset-backed security" that is broader than the definition contained in Regulation AB under the Securities Act; (ii) require that the Federal banking agencies and the SEC (and, with respect to residential mortgage assets, jointly with the Secretary of Housing and Urban development and the Federal Housing Finance Agency), coordinated by the Chairman of the Oversight Council, prescribe rules and regulations setting out criteria, requirements and guidelines for entities being "securitizers" and "originators" (as defined in Subtitle D) in transactions involving asset-backed securities to retain certain amounts of credit risk with respect to the assets underlying or collateralizing such asset-backed securities; (iii) set minimum standards for the credit risk retention regulations to be promulgated by the Federal banking agencies and the SEC; (iv) impose certain new disclosure and diligence requirements for issuers of asset-backed securities, including disclosing in registration statements information regarding underlying assets and the nature of asset review conducted by the asset-backed securities issuer, in addition to removing an exemption from registration for certain mortgage-backed securities; (v) direct the SEC to prescribe regulations requiring that NRSROs describe, in their rating reports, the representations, warranties and enforcement mechanisms contained in the security issues that they rate and how such representations, warranties and enforcement mechanisms differ from those in similar asset-backed securities issuances; and (vi) require a macroeconomic effects study on the risk retention requirements and other amendments implemented under Subtitle D within 180 days of enactment of the Act.

Risk retention regulations are required to be promulgated by the appropriate Federal agencies and the SEC within 270 days following the enactment of the Exchange Act section included in Subtitle D of Title IX, and will be required to be effective (i) one year after publication in the Federal Register for securitizers and originators of asset-backed securities backed by residential mortgages, and (ii) two years after such publication for securitizers and originators of all other classes of asset-backed securities. SEC regulations requiring rating agency disclosure of representations and warranties contained in asset-backed securities transactions, and regulations requiring asset diligence and disclosure of diligence reviews by issuers, are to be promulgated within 180 days following the enactment of Subtitle D of Title IX.

Syndicated Lending

The Act contains certain risk retention provisions (colloquially referred to as "skin-in-the-game" provisions) that require any "securitizer" to retain a portion of the credit risk of any asset transferred, sold or conveyed by the securitizer to a third party. Please see page 75 for a brief discussion of the skin-in-the-game provisions and potential effects on the syndicated loan market.

Subtitle E of Title IX: Accountability and Executive Compensation

The Act contains significant executive compensation-related reforms, which include the following:

- A separate non-binding resolution subject to shareholder vote (commonly referred to as "say-on-pay") to approve certain executive compensation, to be included in proxy or consent or authorization materials, and a separate vote as to payments and benefits based on a change in control ("golden parachutes"), unless such golden parachute amounts are included in the general compensation disclosure and resolution;
- Various requirements pertaining to compensation committee matters, including the independence of compensation committees, compensation consultants and other advisors;
- Additional executive compensation disclosure requirements, including the disclosure of the relationship between executive compensation that was actually paid (and which is required to be disclosed) and a company's financial performance;
- Requirements to develop and implement a clawback policy with respect to awards of incentive-based compensation if financials on which such amounts are awarded prove inaccurate;
- Requirement to disclose its employee and director hedging policy;
- Requirement for standards to be established by the Federal Reserve to prohibit excessive compensation by holding companies of depository institutions; and
- A prohibition of brokers from voting shares on the election of directors, executive compensation or other significant matters, as determined by the SEC.

Title X: Bureau of Consumer Financial Protection

Title X creates a new Bureau of Consumer Financial Protection to centralize responsibility (currently dispersed among the federal banking regulators and other agencies) for implementing, examining and enforcing compliance with federal consumer financial protection laws and establishes certain new consumer protection measures.

Title XI: Federal Reserve System Provisions

Amendments to Emergency Lending Authority

The Act amends Section 13 of the Federal Reserve Act ("FRA") to prohibit the Federal Reserve from extending credit in unusual and exigent circumstances to an individual, partnership, or corporation other than through a "program or facility with broad-based eligibility."

Review of Special Federal Reserve Credit Facilities

The Act authorizes the GAO to conduct reviews, including on-site examinations of the Federal Reserve, any open market transaction or discount window advance that meets the definition of "covered transaction" in section 11(s) of the FRA ("covered transactions"), and any program or facility, including any SPV or other entity, established by or on behalf of the Federal Reserve (a "credit facility") pursuant to section 13 of the FRA, if the GAO determines that such reviews are appropriate.

Emergency Financial Stabilization Programs

Upon written determination of the FDIC and the Federal Reserve, the FDIC will create a widely available program to guarantee the obligations of solvent insured depository institutions or insured depository institutions holding companies (including their affiliates) during times of severe economic distress, except that such program may not include the provision of equity in any form.

Federal Reserve Governance Amendments

The FRA will be amended to prohibit directors representative of the stockholding banks to vote for the appointment of Federal Reserve Bank presidents. No later than one year after the enactment of the Act, the GAO will audit the governance of the Federal Reserve Bank system. The GAO should also conduct an audit of all financial assistance provided by the Federal Reserve during the period from December 1, 2007 until the enactment of the Act. The Act mandates the Federal Reserve to publish on its website information about the financial assistance it has provided during the period from December 1, 2007 until the enactment of the Act.

Title XII: Improving Access to Mainstream Financial Institutions

Title XII is intended to encourage initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream. It seeks to accomplish this goal by, among other things: (i) expanding access to mainstream financial institutions; (ii) providing low-cost alternatives to small dollar loans; and (iii) providing grants to establish loan-loss reserve funds.

Title XIII: Pay It Back Act

Title XIII will cause the reduction of TARP funding to $475 billion and cause certain recaptured, returned and repaid proceeds and funds, such as the proceeds from the sales of Fannie Mae and Freddie Mac, to be applied solely toward deficit reduction, provided that, under certain circumstances, the President will be able to waive the recapture of certain funds, preventing their application toward deficit reduction, and reserve such funds for future appropriation.

Title XIV: Mortgage Reform

The Mortgage Reform and Anti-Predatory Lending Act (the “Act”) is a response to the residential mortgage crisis and perceived predatory lending practices, foreclosure scams and a lack of public education on the financial risks of homeownership. The Act provides support for homeowners throughout the home buying and ownership process, including obtaining a mortgage, refinancing, disputes with lenders and possible foreclosures. The Act also requires the completion of several studies and the creation of new programs. The regulations required to give effect to the various provisions of the Act, however, will take effect within two and half years.

Title XV: Miscellaneous

Title XV of the Act requires the US Executive Director of the IMF to evaluate proposed loans to a country whose public debt exceeds its gross domestic product and to oppose such proposed loans if the loan is not likely to be repaid in full. In addition, Title XV requires any 1934 Act reporting company that uses certain minerals to make certain disclosures regarding whether these minerals originated in the Democratic Republic of Congo or an adjoining country.

Title XVI: Section 1256 Contracts

Section 1601 of the Act defines a “section 1256 contract” under the Internal Revenue Code to exclude (i) any securities futures contract or option on such a contract unless such contract or option is a dealer securities futures contract, or (ii) any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement.

Title I.
Systemic Risk Regulation

Systemic Risk Regulation

Financial Stability Oversight Council

Council Establishment

The Act provides for the establishment of a Financial Stability Oversight Council (the "Council"). The Council is chaired by the Secretary of the Treasury and comprises the heads of the Federal Reserve, the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the Federal Deposit Insurance Corporation ("FDIC"), the Federal Housing Finance Agency ("FHFA"), the Bureau of Consumer Financial Protection ("BCFP"), the National Credit Union Administration, and an independent member appointed by the President with insurance expertise. The Council shall meet no less frequently than quarterly and will make decisions by majority vote.

Council Duties

The Council is generally tasked with identifying and responding to systemic risks and its duties, among other things, include: (i) designating systemically important "nonbank financial companies" and financial market utilities and payment, clearing, and settlement activities; (ii) making recommendations concerning the establishment by the Federal Reserve of heightened regulatory capital standards, leverage, liquidity, contingent capital, resolution plans, concentration limits, enhanced disclosures and overall risk management standards for systemically important bank holding companies and "nonbank financial companies;" (iii) collection of financial information from member agencies for assessing systemic risks; and (iv) making recommendations to member agencies concerning supervisory standards, priorities, and principles.

Nonbank Financial Holding Companies Defined

A "nonbank financial company" is any company that is predominantly engaged in activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act ("BHCA")). A company is predominantly engaged in financial activities if it derives more than 85 percent of its gross revenues from such activities or its consolidated assets related to such activities represent 85 percent or more of consolidated assets.

Designation of Systemically Important Financial Holding Companies

A nonbank financial company that the Council determines could pose a threat to the financial stability of the United States ("NBFC") is required to register with, and is subject to supervisory and prudential standards imposed by the Federal Reserve. Foreign nonbank financial companies may also be deemed to be systemically important and subjected to supervision and regulation by the Federal Reserve if the Council determines that material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the foreign nonbank financial company could pose a threat to the financial stability of the United States. In making such a determination, the Council shall consult with the appropriate home country supervisor, if any, of the foreign nonbank financial company that is being considered for such a determination. Large, interconnected bank holding companies ("LIBHCs") are also generally treated as systemically important.

The factors that the Council must consider in designating a nonbank financial company as systemically important shall include: (i) extent of leverage; (ii) amount and nature of the company's financial assets and liabilities; (iii) extent and nature of off-balance sheet exposures; (iv) extent and nature of transactions and relationships of the company with other significant financial companies; (v) the importance of the company as a source of credit for households, businesses, government entities, and as a source of liquidity for the US financial system; and (vi) any other risk-related factors that the Council deems appropriate.

Any bank holding company ("BHC") with total consolidated assets of $50 billion or more as of January 1, 2010, which received financial assistance under the Capital Purchase Program established under the Emergency Economic Stabilization Act of 2008, that ceases to be a BHC will automatically be treated as an NBFC subject to supervision and regulation by the Federal Reserve.

An NBFC may establish an intermediate holding company, under which it conducts financial activities subject to prudential standards and Federal Reserve supervision; nonfinancial activities of the

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company shall not be subject to prudential standards and Federal Reserve supervision.

Prudential Standards Recommendations

To mitigate systemic risk the Council may make recommendations to the Federal Reserve concerning the establishment and enhancement of prudential standards applicable to NBFCs and LIBHCs. In making such recommendations, the Council may: (i) differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Council deems appropriate; or (ii) recommend an asset threshold higher than $50 billion for the application of any standard.

The enhanced supervision and prudential standards that the Council may recommend include: (i) enhanced risk-based capital requirements; (ii) leverage limits; (iii) liquidity requirements; (iv) resolution plan ("living will") and credit exposure report requirements; (v) concentration limits; (vi) a contingent capital requirement (requiring a minimum amount of contingent capital that is convertible to equity in times of financial distress); (vii) enhanced public disclosures; (viii) short term debt limits; and (ix) overall risk management requirements.

In making recommendations concerning the applicability of enhanced supervision and prudential standards with respect to foreign-based NBFCs or LIBHCs, the Council shall give due regard to the principles of national treatment and competitive equality and shall take into account the extent to which an NBFC or LIBHC is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States. Also, before requiring the submission of reports from a company that is a foreign NBFC or foreign-based LIBHC, the Council shall, to the extent appropriate, consult with the appropriate foreign regulator of such company and, whenever possible, rely on information already being collected by such foreign regulator, with English translation. Further, more generally, in exercising its duties with respect to foreign NBFCs or LIBHCs and cross-border activities and markets, the Council shall consult with appropriate foreign regulatory authorities, to the extent appropriate.

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Activity Limitations and Divestitures

The Act provides that if the Federal Reserve determines that a BHC with total consolidated assets of $50 billion or more or NBFC poses a grave danger to the financial stability of the United States, the Federal Reserve, upon affirmative vote of not less than 2/3 of the members of the Council, shall require the subject company to: (i) terminate activities; (ii) impose conditions on the conduct of activities; (iii) limit any expansion; or (iv) dispose of assets or off-balance-sheet items.

Office of Financial Research

An Office of Financial Research ("OFR") shall be established within the Treasury Department. The OFR will be headed by a Director appointed by the President with consent of the Senate. The purpose of the OFR is to support the Council and the financial regulatory agencies by, among other things: (i) collecting data, including financial transaction and position data; (ii) standardizing the types of data reported and collected; and (iii) developing tools for risk management and monitoring. The OFR shall issue rules, regulations, and orders to the extent necessary to carry out its duties. The financial regulatory agencies, in consultation with the OFR, shall implement regulations promulgated by the OFR to standardize the types and formats of data reported and collected on behalf of the Council. The OFR shall have the power to issue subpoenas (enforceable in a district court) for the production of data that the OFR is authorized to collect. The OFR is funded by an assessment on NBFCs and BHCs with total consolidated assets of $50 billion or more.

The OFR shall prepare and make public: (i) a financial company reference database; (ii) a financial instruments reference database; and (iii) standards for reporting financial transactions and positions data to the OFR. The OFR shall not, however, make public any "confidential data."

The OFR shall develop independent analytical capabilities and computing resources to, among other things: (i) develop and maintain metrics and reporting systems for systemic risk; (ii) monitor, investigate, and report on changes in system-wide risk levels and patterns; (iii) conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets; (iv) evaluate and report on stress tests; and (v) promote best practices for financial risk management.

"The Act provides that if the Federal Reserve determines that a BHC with total consolidated assets of $50 billion or more or NBFC poses a grave danger to the financial stability of the United States, the Federal Reserve, upon affirmative vote of not less than 2/3 of the members of the Council, shall require the subject company to: (i) terminate activities; (ii) impose conditions on the conduct of activities; (iii) limit any expansion; or (iv) dispose of assets or off-balance-sheet items."

Federal Reserve Authority over NBFCs and LIBHCs

Regulatory Reports and Examination Authority

The Act provides that the Federal Reserve may require reports and examine any NBFC and its subsidiaries to assess: (i) the nature of the operations and the financial condition of the company; (ii) the risk the company may pose to the financial system and its systems for monitoring and controlling such risks; and (iii) compliance with regulatory requirements. The Federal Reserve shall coordinate with an NBFC's primary financial regulator and, to the fullest extent possible, use existing examination reports or other available supervisory information prior to requiring reports and conducting examinations of NBFCs.

Enforcement Authority

If the Federal Reserve determines that an NBFC is not in compliance with Federal Reserve regulations or poses a threat to financial stability, the Federal Reserve may recommend an enforcement action to the NBFC's primary financial regulator and, if the primary financial regulator does not take an enforcement action acceptable to the Federal Reserve, the Federal Reserve has a back-up authority to itself impose such an enforcement action.

Prior Approval Requirements

NBFCs will be treated as BHCs for purposes of Section 3 of the BHCA. NBFCs and BHCs with total consolidated assets of $50 billion or more shall generally be required to seek Federal Reserve approval prior to acquiring shares of companies with assets of $10 billion or more engaged in financial activities other than activities authorized under Section 4(c)(8) and 4(k)(4)(E) of the BHCA.

BHCA exemptions from the prior notice requirements for nonbanking acquisitions for well managed and well capitalized institutions are eliminated with respect to NBFCs and BHCs with total consolidated assets of $50 billion or more. In addition to the BHCA's existing standards for approval of nonbanking acquisitions, the Federal Reserve is required to consider risks to financial stability that may arise out of such acquisitions.

Prudential Standards

The Federal Reserve is required, on its own or pursuant to recommendations by the Council, to establish prudential standards and disclosure requirements for NBFCs and BHCs with total consolidated assets of $50 billion or more (for ease of reference we shall also refer to such BHCs as "LIBHCs") that are more stringent than the requirements applicable to BHCs and that may increase in stringency depending on a number of factors. In prescribing more stringent prudential standards the Federal Reserve may, on its own or pursuant to a recommendation by the Council, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Federal Reserve deems appropriate. The Federal Reserve may, pursuant to a recommendation by the Council, establish an asset threshold higher than $50 billion for the application of any standard.

In applying the enhanced prudential standards to foreign NBFCs or foreign-based LIBHCs, the Federal Reserve shall give due regard to the principle of national treatment and competitive equality, taking into account the extent to which the foreign NBFC or foreign-based LIBHC is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

The Federal Reserve has a broad mandate to establish prudential standards for NBFCs and LIBHCs that shall include:

"The Federal Reserve is required, on its own or pursuant to recommendations by the Council, to establish prudential standards and disclosure requirements to NBFCs and BHCs with total consolidated assets of $50 billion or more that are more stringent than the requirements applicable to BHCs and that may increase in stringency depending on a number of factors."

(i) risk-based capital requirements; (ii) leverage limits; (iii) liquidity requirements; (iv) overall risk management requirements; (v) resolution plan and credit exposure requirements; and (vi) concentration limits. Such prudential standards may also include: (i) contingent capital requirement; (ii) enhanced public disclosures; (iii) short-term debt limits; and (iv) such other prudential standards that the Federal Reserve determines are appropriate.

Capital Adequacy Requirements

The Act requires the Federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions, their holding companies, and NBFCs that shall be no less than the leverage and risk-based capital requirements currently in effect for FDIC-insured depository institutions under the Prompt Corrective Action framework established by the FDIA (the "minimum capital requirement"). There are some differences in the regulatory capital treatment currently applicable to FDIC-insured depository institutions and BHCs and, as a result of the minimum capital requirement, BHCs are no longer able to include certain instruments in Tier I capital, most notably, qualifying trust preferred securities. The inclusion in Tier I capital of such instruments issued prior to May 19, 2010, shall be phased out over a 3 year period commencing on January 1, 2013. Depository institution holding companies with total consolidated assets of less than $15 billion are able to continue to include in Tier I capital such instruments issued prior to May 19, 2010.

The Act clarifies that the minimum capital requirement does not require depository institution holding companies to deduct from regulatory capital investments in financial subsidiaries (even though insured depository institutions are required to deduct such investments), unless such capital deduction is otherwise required by the appropriate regulatory agency.

Depository institution holding companies not previously supervised by the Federal Reserve and bank holding company subsidiaries of foreign banking organizations shall become subject to the leverage and minimum risk-based capital requirements 5 years after the enactment of the Act.

In addition, the Federal banking agencies shall establish capital requirements applicable to all depository institutions, their holding companies, and NBFCs that shall address the risks that such institutions pose to "other public and private stakeholders," including specifically the risks arising from: (i) significant volumes of activity in derivatives, securitizations, financial guarantees, repurchase agreements, and securities borrowing and lending; (ii) concentrations in assets with reported values based on models rather than historical cost; and (iii) concentration in market share for any activity that would substantially disrupt financial markets if the institution unexpectedly ceases the activity.

The Federal Reserve may promulgate regulations that require NBFCs and LIBHCs to maintain a minimum amount of contingent capital that is convertible to equity in times of financial distress.

GAO Capital Studies

The Government Accountability Office ("GAO") shall conduct a study of the use of hybrid capital instruments as a component

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of Tier I capital. GAO shall also be tasked to study capital requirements applicable to US intermediate holding companies of foreign banks that are BHCs or savings and loan holding companies ("SLHCs"). Within 18 months of the enactment of the Act, the GAO shall submit reports summarizing the results of the studies to the Congressional banking committees, which shall include specific recommendations for legislative or regulatory action regarding the treatment of hybrid capital instruments, including trust preferred shares.

Special Leverage Requirement

The Federal Reserve shall require an LIBHC or an NBFC to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that such a company poses a "grave threat" to the financial stability of the United States and the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States. The computation of capital for purposes of meeting the leverage requirement shall take into account any off-balance-sheet activities of the company.

Living Wills

The Federal Reserve is specifically required to issue rules within 18 months of enactment of the Act that require NBFCs and LIBHCs to periodically submit to the Federal Reserve, the Council, and the FDIC: (i) report of exposures to other NBFCs and LIBHCs; and (ii) a plan for rapid and orderly resolution in the event of material financial distress or failure ("living will"). If the Federal Reserve and the FDIC determine that a living will is not credible or adequate, the company is required to re-submit the living will within a time frame specified by the Federal Reserve and the FDIC. Failure to resubmit a credible plan may result in the imposition of more stringent capital, leverage, or liquidity requirements or restrictions on the growth, activities or operations of the company. If the company fails to resubmit a living will that remedies the deficiencies within 2 years of the imposition of more stringent prudential requirements, the Federal Reserve and the FDIC, in consultation with the Council, may order divestiture of assets or operations of the company.

Short-term Debt Limits

The Federal Reserve may by regulation prescribe a limit on the amount of short-term debt, including off-balance-sheet exposures, that may be accumulated by any LIBHC and NBHC. Any such limit shall be based on the short-term debt of the company as a percentage of capital stock and surplus of the company or on such other measures as the Board of Governors considers appropriate. The Federal Reserve shall define by regulation the meaning of "short-term debt" but the term does not include insured deposits.

Credit Exposure Concentration Limits

The Federal Reserve shall prohibit by regulation credit exposures by NBFCs and LIBHCs to an unaffiliated company that exceeds 25 percent of the capital and surplus of the company. The Federal Reserve is authorized to lower the 25 percent threshold. The Act defines the term "credit exposure" very broadly to include: extensions of credit, repurchase agreements, securities borrowing and lending, guarantees, letters of credit, and

"The Act would require the Federal Reserve to conduct annual "stress tests," in coordination with the appropriate primary financial regulatory agency, to determine whether NBFCs and LIBHCs have sufficient capital to absorb losses as a result of adverse economic conditions. The Federal Reserve shall publish a summary of the test results and shall require NBFCs and LIBHCs to update their living wills as the Federal Reserve determines appropriate, based on the results of such tests."

"all purchases of or investments in securities issued by the company." The Federal Reserve is granted broad discretion to expand and carve out exemptions from the definition of covered credit exposures.

Risk Management Standards

The Federal Reserve shall require publicly traded NBFCs and BHCs with total consolidated assets of $10 billion or more to establish a risk committee responsible for the oversight of the enterprise-wide risk management practices. The Federal Reserve may require publicly traded BHCs with total consolidated assets of less than $10 billion to also establish risk committees. The risk committees shall include a number of independent directors to be determined by the Federal Reserve based on the nature of operations, size of assets, and other criteria the Federal Reserve deems appropriate, and shall include at least 1 risk management expert with experience in identifying, assessing, and managing risk exposures of large, complex firms.

Stress Tests

The Act requires the Federal Reserve to conduct annual "stress tests," in coordination with the appropriate primary financial regulatory agency, to determine whether NBFCs and LIBHCs have sufficient capital to absorb losses as a result of adverse economic conditions. The Federal Reserve shall publish a summary of the test results and shall require NBFCs and LIBHCs to update their living wills as the Federal Reserve determines appropriate, based on the results of such tests.

The Act also requires NBFCs and LIBHCs to conduct semiannual stress tests; financial companies with total consolidated assets of more than $10,000 shall conduct annual stress tests. A company subject to the stress test requirement shall report the stress test results to the Federal Reserve and its primary financial regulatory agency. Each Federal primary financial regulatory agency shall issue rules establishing the form and content of such reports, specifying the methodology for the conduct of stress tests and requiring public release of the stress test results.

Prompt Corrective Action

The Federal Reserve, in consultation with the Council and the FDIC, shall promulgate regulations for early remediation of financial distress of NBFCs and LIBHCs that requires defining regulatory capital and liquidity thresholds of financial decline that triggers, among other things, a capital restoration plan and capital raising requirements, limits on transactions with affiliates, management changes, and asset sales. Essentially, the Act requires the establishment of a remediation framework for NBFCs and LIBHCs modeled on the Prompt Corrective Action framework currently applicable to insured depository institutions.

Organization Structure Requirements

The Federal Reserve shall promulgate regulations to: (i) establish criteria for determining whether to require NBFCs to establish an intermediate holding company in which to conduct financial activities; and (ii) to establish any restrictions on transactions between such intermediate company and its affiliates. A company that directly or indirectly controls such an intermediate holding company shall be required to serve as a source of strength to its subsidiary intermediate holding company.

Special FDIC Examination Authority

The FDIC is authorized to conduct a special examination of any depository institution, NBFC, or LIBHC, to determine the condition of such depository institution for insurance purposes, or of such NBFC or LIBHC for the purpose of implementing the resolution authority provided for in the Act. The FDIC may not use this special examination authority with respect to a company that is in a generally sound condition.

New Standard for Approval and Termination of US Offices of Foreign Banks and Broker-Dealers

The Act adds an additional standard for approval of US banking offices of foreign banks, which requires, in the case of a "foreign bank that presents a risk to the stability of United States financial system", the Federal Reserve to consider whether the home country of the foreign bank has adopted, or is making demonstrable

> "The Act also authorizes the Federal Reserve, after notice and opportunity for a hearing, to terminate the banking activities for any "foreign bank that presents a risk to the stability of United States financial system" if the home country of the foreign bank has not adopted or made demonstrable progress toward adopting an appropriate system of financial regulation to mitigate such risk."

progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk. The Act also authorizes the Federal Reserve, after notice and opportunity for a hearing, to terminate the banking activities for any "foreign bank that presents a risk to the stability of United States financial system" if the home country of the foreign bank has not adopted or made demonstrable progress toward adopting an appropriate system of financial regulation to mitigate such risk.

Similarly, the Act provides that the SEC may consider, in determining whether to permit a foreign person or an affiliate of a foreign person that presents a risk to the stability of the United States financial system to register as a United States broker or dealer, whether the home country of the foreign person has adopted or made demonstrable progress toward adopting an appropriate system of financial regulation to mitigate such risk. The SEC may also determine to terminate the registration a foreign person or an affiliate of a foreign person that presents a risk to the stability of the United States financial system if the Commission determines that the home country of the foreign person has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.

> "The SEC may also terminate the registration a foreign person or an affiliate of a foreign person that presents a risk to the stability of the United States financial system if the Commission determines that the home country of the foreign person has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk."

The Act does not specify how a determination should be made as to whether a foreign bank or person poses a risk to the stability of United States financial system. It is likely that such determination will be similar to the determination of systemic importance and will likely encompass large, interconnected foreign banking organizations and broker-dealers.

International Policy Coordination

The Act contains explicit provisions requiring the President, the Council, the Treasury, and the Federal Reserve to consult and coordinate with foreign counterparts to address matters relating to systemic risk.

Title II.
Orderly Liquidation Authority

Orderly Liquidation Authority

Introduction

The Act creates a new regime for liquidation of financial companies whose potential collapse might jeopardize financial stability in the United States ("**Covered Financial Companies**"). The orderly liquidation authority ("OLA") contemplated by the Act allows the Federal Deposit Insurance Corporation (the "FDIC") to seize exclusive control of a failing nonbank financial company or bank holding company if the Treasury Secretary in consultation with the Board of the Federal Reserve ("FRB") and the FDIC determined that such a company presented a systemic risk. The FDIC administers the liquidation of such a Covered Financial Company as receiver in accordance with the OLA provisions. Once a failing Covered Financial Company is placed under the OLA, any insolvency proceedings under the US Bankruptcy Code will be preempted, and the debtor will be liquidated, and may not be reorganized or rehabilitated.

With certain variations, the OLA is largely modeled after the existing framework for insolvent banks under the FDIA.

OLA Process Limited to Covered Financial Companies and Covered Broker Dealers

An OLA proceeding may be initiated only with respect to a Covered Financial Company, which is a "financial company" designated as a "covered financial company" by the Treasury Secretary.

Financial Companies

The OLA potentially applies to the following types of entities organized under the laws of a state or of the United States (each, a "Financial Company"):

- a bank holding company;
- a non-bank financial company supervised by the FRB;
- any company "predominantly engaged" in activities that the FRB has determined are "financial in nature" or incidental thereto (a financial company is deemed to be "predominantly engaged" in financial activities if at least 85% of its and all its affiliates' consolidated revenues are derived from activities that are financial in nature); and
- any subsidiary of any of the foregoing that is predominantly engaged in activities that the FRB has determined are financial in nature (other than an insured depository institution).

Comment: Not Applicable to Foreign Subsidiaries and No Consolidation Rights. The Act does not permit OLA proceedings to apply to non-US entities. Nor does the Act give any rights to the receiver to consolidate an entity with a subsidiary or affiliate in an OLA proceeding, although the Act does not explicitly prohibit such consolidation under existing principles of substantive consolidation.

Covered Financial Companies

An OLA proceeding may be invoked only if each of the FRB and the FDIC, by a supermajority of two-thirds of the board of the FRB or the FDIC, recommend an OLA proceeding. The Secretary of the Treasury (in consultation with the President) must then determine whether the Financial Company satisfies each element of the following test:

1. Default or Danger of Default
First, a Financial Company must be in "default or danger of default," a condition which is deemed to occur if:

- a bankruptcy case has been, or likely will be, commenced with respect to a Financial Company; or
- the Financial Company has incurred, or is likely to incur, losses that will deplete all or substantially all of the Financial Company's capital with no reasonable prospect to avoid such depletion; or
- the obligations of the Financial Company to creditors and others exceed, or are likely to exceed, its assets; or
- the Financial Company is, or is likely to be, unable to pay its obligations in the normal course of business.

2. Systemic Risk Determination
Second, the failure of the Financial Company has serious adverse effects on financial stability in the United States.

3. No Viable Private Sector Alternative to OLA Proceeding
Third, no viable private sector alternative is available to prevent the default.

4. OLA Proceeding Appropriate
Fourth, any effect of commencing an OLA proceeding with respect to the Financial Company's creditors, shareholders and relevant market participants is appropriate given the scope of the adverse impact on financial stability in the United States as a whole.

5. OLA Proceeding Mitigates Adverse Effects of Default
Fifth, the actions proposed under the OLA mitigate the adverse effects on the US financial system.

6. Order to Convert Debt Instruments
Sixth, a federal agency orders the Financial Company to convert all its convertible debt instruments that are subject to regulatory order.

Registered Broker-Dealers

For a registered broker-dealer or for a financial company in which the largest US subsidiary is a registered broker-dealer, the initial recommendation for an OLA proceeding must come from the SEC (rather than the FDIC) as well as the FRB.

Insurance Companies

For an insurance company or for a financial company in which the largest US subsidiary is an insurance company, the initial recommendation for an OLA proceeding must come from the Director of the Federal Insurance Office (rather than the FDIC) as well as the FRB. The liquidation or rehabilitation of insurance companies and any insurance subsidiaries of a Covered Financial Company remains subject to the applicable state insurance laws, although the FDIC is authorized to commence judicial action in a state court if the relevant state insurance regulator fails to commence any proceeding within 60 days after the failing insurance company is determined to be a Covered Financial Company.

FDIC Insured Depository Institutions

The liquidation of insured depository institutions would be subject to the existing FDIA procedures.

Receivership Powers under the OLA

Appointment of the FDIC as Receiver

If the Treasury Secretary determines that a company is a Covered Financial Company, as described above, it will notify the company and the FDIC. If the company's board consents, the FDIC will be appointed as receiver. If the company does not consent, the Treasury Secretary's determination is subject to judicial review and, if the court agrees with the Treasury Secretary's determination or fails to act, then the FDIC will be appointed as receiver.

Appointment of SIPC as Trustee

If the relevant Covered Financial Company is a registered broker-dealer, the FDIC appoints the Securities Investor Protection Corporation ("SIPC") to act as trustee of the failing Covered Broker Dealer and has full authority to liquidate the failing registered broker-dealer in accordance with the Securities Investor Protection Act of 1970 (the "SIPA") liquidation provisions.

Exclusion of US Bankruptcy Code and Other Bankruptcy Proceedings

Upon the appointment of the FDIC as receiver or SIPC as trustee, as applicable, any bankruptcy proceeding involving the Covered Financial Company will be dismissed.

The FDIC as Receiver of Covered Financial Companies

The FDIC, when acting as receiver of a Covered Financial Company, will have broad powers that largely mirror its existing receivership powers under the FDIA. As receiver under the OLA, the FDIC succeeds to the rights, title, powers and privileges of the Covered Financial Company and operates the Covered Financial Company with all of the powers of its members or shareholders, directors and officers.

1. General Powers

Under the OLA, the FDIC may, among other things:

- liquidate and wind-up the affairs of the Covered Financial Company;
- appoint itself as receiver of any subsidiary (other than an insured depository institution, insurance company, or registered broker-dealer) that is in default or in danger of default, under certain circumstances;
- exercise subpoena powers;
- create a bridge financial company to acquire the Covered Financial Company's assets;
- merge the Covered Financial Company with another company or transfer any asset or liability of the Covered Financial Company without any approval or consent;
- at any time after its appointment as receiver, request a stay in any judicial action or proceeding in which the Covered Financial Company is or becomes a party for a period of up to 90 days (which request must be granted by the court);
- utilize private sector services to mange and dispose of assets.

2. Substantive Treatment of Creditor Claims; Avoidance and Repudiation Powers

Generally, the FDIC, in its capacity as receiver of a Covered Financial Company, has powers substantially similar to those it presently has under the FDIA. In addition, the Act also includes provisions relating to substantive treatment of creditor claims that are based on the corresponding provisions set forth under the U.S. Bankruptcy Code, intended to address a broader range of activities than those of a depository institution.

Under the Act, the FDIC has the authority to avoid fraudulent and preferential transfers, disaffirm or repudiate any burdensome contracts or leases, and enforce any contract notwithstanding any provisions for termination, default, acceleration, or exercise of rights upon insolvency (with carveouts for qualified financial contracts similar to those set forth under the U.S. Bankruptcy Code and discussed below).

In addition, the Act provides that a default may not be declared under a contract with a Covered Financial Company for a period of 90 days after the appointment of the FDIC without the FDIC's consent.

3. Priority of Expenses and Unsecured Claims

The OLA modifies the existing priority of unsecured claims under the FDIA by giving wage and benefit claims of non-executive employees priority over general unsecured and subordinated debt creditors, but subordinating any such claims of senior executive employees of the Covered Financial Company to all junior creditor obligations.

4. Treatment of Creditors

The FDIC as receiver is expressly permitted not to treat similarly situated creditors in a similar manner and in accordance with the priority of payment if: (i) all similarly situated creditors receive at least an amount they would have received in a liquidation proceeding under the U.S. Bankruptcy Code and (ii) such disparate treatment, in the FDIC's discretion, is necessary to maximize value of the Covered Financial Company's assets, continue operations of the receivership, or minimize losses realized upon disposition of the assets.

5. Coordination with Foreign Financial Authorities

The FDIC as a receiver is required to coordinate, to the maximum extent possible, with any appropriate foreign financial authorities regarding the orderly liquidation of a Covered Financial Company that has any assets or operations outside of the United States.

6. Qualified Financial Contracts; Safe Harbor Provisions

Qualified financial contracts are defined as swap agreements, securities contracts, repurchase agreements, forward contracts and commodity contracts (collectively, "QFCs"). The Act includes safe harbor provisions for QFCs that are similar to the QFC-related provisions contained in the FDIA and stays counterparties from exercising termination, close out and netting rights under a QFC with a Covered Financial Company for one business day after the appointment of the FDIC as receiver (the "**QFC Transfer Period**"), during which period the FDIC as receiver may transfer all QFCs to a bridge financial company or other acquirer.

- *QFC Transfers.* During the QFC Transfer Period, the FDIC as receiver must either (i) transfer all QFCs between the Covered Financial Company and an individual counterparty (and the counterparty's affiliates) to the same financial institution, or (ii) not transfer **any** QFCs involving that counterparty (and the counterparty's affiliates). The FDIC as receiver may transfer the QFCs to a non-U.S. financial institution only if the contractual rights of the counterparty to such QFCs are enforceable substantially to the same extent as set out under the OLA.
- *QFC Safe Harbor Provisions.* At any time following the expiration of the QFC Transfer Period, the non-defaulting counterparty to a QFC is not stayed from exercising any of its rights to terminate the QFC and all outstanding transactions, net and set off any termination amounts, and liquidate and apply any collateral transferred to it by the Covered Financial Company under a relevant security arrangement in connection with the QFC. In addition, absent the counterparty's actual intent to hinder, delay, or defraud the Covered Financial Company, any of its creditors or the FDIC as receiver, the FDIC is not able to reclaim or avoid any collateral transfer made by the Covered Financial Company in respect of any QFC.
- *Repudiation of QFCs by the FDIC as receiver.* The FDIC as receiver, in its discretion, is permitted to repudiate QFCs and terminate any outstanding transactions, but is required to either (i) terminate **all** QFCs between the Covered Financial Company and an individual counterparty (and the counterparty's affiliates) or (ii) not terminate **any** QFCs involving those parties.
- *"Walkaway" Clauses Unenforceable.* Any clause in a QFC that extinguishes a payment obligation of a non-defaulting party to a Covered Financial Company solely due to the Covered Financial Company's insolvency is deemed a "walkaway" clause and would be unenforceable under the OLA regime.

7. Enforcement of Contracts Guaranteed by a Covered Financial Company

With respect to any contracts that are guaranteed by a Covered Financial Company subject to a receivership of the FDIC, the FDIC as receiver has a right to enforce obligations of a primary obligor that ordinarily is subject to termination upon the insolvency of its credit support provider if: (i) within the QFC Transfer Period that is applicable to such Covered Financial Company, the guarantee and all related assets and liabilities are transferred to, and assumed by, a third party, or, alternatively, (ii) the FDIC provides adequate protection with respect to such obligations.

8. The FDIC Receivership Proceedings Duration Is Limited

The term of the FDIC's receivership of a Covered Financial Company is limited to an initial period of three years, subject to two one-year extensions.

SIPC and Registered Broker-Dealers

The FDIC is required to appoint SIPC as trustee for the liquidation of a registered broker-dealer subject to an OLA proceeding. The FDIC's involvement is limited to providing funding and exercising certain powers, including the establishment of a bridge financial company, transferring assets and liabilities, repudiating contracts and determining claims. If the FDIC establishes a bridge financial company with respect to a failing broker-dealer, the FDIC transfers all customer accounts and all customer property to such financial company unless the transfer of customer property would adversely affect the FDIC's ability to avoid serious impact on the U.S. financial system, or SIPC determines that customer property is transferred to another registered broker-dealer.

SIPC is entitled to exercise all of its powers under the SIPA but would not have jurisdiction over assets and liabilities transferred by the FDIC to any bridge financial company. QFCs to which a broker-dealer is a party are governed exclusively by the OLA's safe harbor provisions.

Orderly Liquidation Fund

The Act establishes an orderly liquidation fund, intended to provide funding for the OLA proceedings, that are held at the Treasury and managed by the FDIC. The FDIC has authority to issue obligations to the Treasury to fund the OLA. The FDIC is restricted from incurring any obligation during the first 30 days of liquidation that results in total obligations outstanding exceeding the sum of 10% of the total consolidated assets of the Covered Financial Company subject to an OLA proceeding. Thereafter, the FDIC may become obligated for up to 90% of the fair value of the total consolidated assets of each Covered Financial Company that are available for repayment.

The FDIC is required to charge risk-based assessments if necessary to repay obligations to the Treasury within five years of issuance.

Title III. Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

Abolishment of the OTS

One year after the date of the enactment of the Act the powers and duties of the Office of Thrift Supervision ("OTS") shall be transferred to the Federal Reserve, the OCC, and the FDIC. The transfer date may be postponed but cannot be later than 18 months after the enactment of the Act. Within 180 days after the enactment of the Act the Federal Reserve, the OCC, and the OTS shall jointly submit a plan detailing the steps that will be taken to accomplish the transfer. All functions of the OTS relating to the supervision and regulation of SLHCs and their subsidiaries (other than depository institution subsidiaries) shall be transferred to the Federal Reserve. All functions of the OTS relating to the supervision and regulation of federal savings associations shall be transferred to the OCC. All functions of the OTS relating to the supervision and regulation of State savings associations shall be transferred to the FDIC. Effective 90 days after the transfer date the OTS would be abolished. The Act does not abolish, however, the Federal savings association charter. The OCC shall designate a Deputy Comptroller, who shall be responsible for the supervision and examination of federal savings associations.

No later than the transfer date the Federal Reserve, the OCC and the FDIC shall identify and publish a list of the regulations that will continue in effect and will be enforced by the respective agency. The Act contains a number of savings provisions, including provisions ensuring the continued effect of all orders, resolutions, determinations, agreements, regulations, interpretations, and other advisory material issued by the OTS.

Agency Funding

The Act provides that the OCC may collect an assessment, fee, or other charges from entities subject to its supervision as the OCC determines necessary or appropriate to carry its responsibilities. In determining the appropriate charge the OCC may take into account the nature and scope of the activities of the entity, the amount and type of its assets, its financial and managerial condition, and any other factor the OCC deems to be appropriate.

The Federal Reserve is similarly authorized to collect an assessment, fee, or other charges from BHCs and SLHCs with assets of $50 billion or more, and NBFCs, that are equal to the total expenses the Federal Reserve estimates are necessary to carry out its supervisory responsibilities with respect to such companies.

The FDIC is authorized to assess the cost of any examination of any depository institution against the institution or as the FDIC determines is necessary or appropriate to carry out its responsibilities.

"The FDIC shall define the term "assessment base" as the amount equal to the average consolidated assets of the insured depository institution during the assessment period minus the average tangible equity of the insured depository institution during the assessment period. The Act extends, until January 1, 2013, the FDIC's Transaction Account Guarantee Program."

Deposit Insurance Reforms

The FDIC shall define the term "assessment base" as the amount equal to the average consolidated assets of the insured depository institution during the assessment period minus the average tangible equity of the insured depository institution during the assessment period. In the case of an insured depository institution that is a "custodial bank" (a term to be defined by the FDIC) or a banker's bank the assessment-based amount is further reduced by an amount the FDIC determines is appropriate for such institutions.

The Act requires that FDIC deposit insurance premiums be raised with respect to banks with more than $10 billion in assets, and requires that the FDIC increase its ratio of reserves to total industry deposits from 1.15% to at least 1.35%.

The Act permanently increases the standard maximum deposit insurance amount from $100,000 to $250,000. The Act also extends, until January 1, 2013, the FDIC's Transaction Account Guarantee Program ("TAGP"). Under the TAGP the FDIC fully insures the net amount maintained by a depositor in a noninterest-bearing transaction account at an insured depository institution. The term 'noninterest-bearing transaction account' means a deposit or account (i) with respect to which interest is neither accrued nor paid; (ii) on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others; and (iii) on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal.

"Upon written determination of the FDIC and the Federal Reserve the FDIC shall create a widely available program to guarantee the obligations of solvent insured depository institutions or insured depository institutions holding companies (including their affiliates) during times of severe economic distress, except that such program may not include the provision of equity in any form."

De Novo Branching by Federal Savings Associations

The Act provides that a savings association that becomes a bank may: (1) continue to operate any branch or agency that the savings association operated immediately before the savings association became a bank; and (2) establish, acquire, and operate additional branches and agencies at any location within any State in which the savings association operated a branch immediately before the savings association became a bank, if the law of the State in which the branch is located, or is to be located, permits establishment of the branch if the bank were a State bank chartered by such State.

Title IV. Regulation of Advisers to Hedge Funds and Others

Regulation of Advisers to Hedge Funds and Others

The Investment Advisers Act of 1940 (the "Advisers Act") is generally the means by which Congress has attempted to regulate sponsors of investment funds. Title IV of the Act, under the heading "Regulation of Advisers to Hedge Funds and Others" (also called the "Private Fund Investment Advisers Registration Act of 2010"), expands the jurisdiction of the Securities and Exchange Commission (the "SEC") over fund sponsors by substantially amending the Advisers Act.

Registration Requirements

Elimination of Private Adviser Exemption

The Act eliminates the exemption from registration under the Advisers Act that is currently provided to investment advisers who, during the course of the prior 12 months, have had fewer than 15 clients and who neither hold themselves out generally to the public as investment advisers nor act as investment advisers to investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act").

Establishment of Exemption for Venture Capital Fund Advisers and Small Private Fund Advisers

Due to the elimination of the private adviser exemption, the Act requires the registration of most investment advisers to privately offered funds that currently use the exemption. The Act also establishes, however, exemption from registration for investment advisers to certain types of alternative investment funds: all private funds (basically, hedge funds and private equity funds) with AUM under $150 million and all "venture capital funds" (the definition of which is also to be determined by the SEC), regardless of AUM. Notwithstanding the exemptions, all exempt investment advisers are still subject to certain reporting requirements as described in the sidebar, "Exemptions to Registration Requirements."

Definition of "Private Fund"

For all purposes of the Act and the Advisers Act, "private fund" would be defined as an issuer that is an investment company as defined in the Investment Company Act but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, which set forth the "100 holders" and "qualified purchasers" exemptions, respectively.

Exemptions to Registration Requirements

- Venture Capital Funds
  - *Exemption.* The Act would amend the Advisers Act by adding an exemption to the registration requirements of the Advisers Act for investment advisers to one or more venture capital funds (and solely to such venture capital fund(s)).
  - *Cap.* There would be no cap on the assets under management of such venture capital fund investment advisers for the exemption to apply.
  - *Definition.* The SEC would be required to issue final rules to define the term "venture capital fund" within one year.
  - *Reporting.* Despite being exempt from registration under the Advisers Act, the SEC would require such advisers to maintain such records and provide to the SEC such annual or other reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.
- Small Private Funds
  - *Exemption.* The Act would amend the Advisers Act by adding an exemption to the registration requirements of the Advisers Act for investment advisers to one or more private funds (and solely to such private funds).
  - *Cap.* Such exemption only applies if the assets under management of such private fund investment adviser are, in the aggregate, less than $150 million.
  - *Definition.* The Act defines "private fund" as an issuer that is an investment company, as defined in the Investment Company Act, but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.
  - *Reporting.* Despite being exempt from registration under the Advisers Act, the SEC will require such advisers to maintain such records and provide to the SEC such annual or other reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

Establishment of SEC Discretion to Require Registration of Mid-Sized Private Fund Advisers

After various, failed attempts to carve-out an additional exemption for private equity fund advisers with assets under management over $150 million (but under a certain cap, at one point proposed as $1 billion), Congress finally agreed to leave the registration of what it refers to as "mid-sized" private funds to the discretion of the SEC. "Mid-sized" is not defined in the Act, but Congress does direct the SEC to take into account the size, governance, and investment strategy of private funds to determine whether they pose systemic risk in prescribing regulations and examination procedures with respect to the registration of investment advisers to mid-sized private funds which reflect the level of systemic risk posed by such funds.

Establishment of Limited Exemption for Foreign Private Advisers

The Act provides a limited exemption from registration under the Advisers Act to any "foreign private adviser," defined as any investment adviser who (i) has no place of business in the United States, (ii) has, in total, fewer than 15 clients and investors in the U.S. in private funds advised by the investment adviser, (iii) has aggregate assets under management attributable to clients in the U.S. and investors in the U.S. in private funds advised by the investment adviser of less than $25 million or such higher amount as the SEC may, by rule, deem appropriate, (iv) does not hold itself out to the public in the U.S. as an investment adviser, and (v) does not act as (a) an investment adviser to an investment company registered under the Investment Company Act or (b) a company that has elected to be a business development company (a "BDC") under the Investment Company Act (and has not withdrawn its election).

Modification of Exemption for Intrastate Advisers

The existing exemption from registration for any investment adviser whose clients are all residents of the state within which such investment adviser maintains its principal office and place of business and who does not advise with respect to securities listed on any national securities exchanges is modified by the Act to carve-out from such exemption an investment adviser to any private fund.

Modification of Exemption for Advisers Registered with the CFTC

The existing exemption from registration for any investment adviser that is registered with the Commodity Futures Trading Commission (the "CFTC") (so long as such adviser does not act as (a) an investment adviser to an investment company registered under the Investment Company Act or (b) a company that has elected to be a BDC (and has not withdrawn its election)) is modified by the Act to state that any such investment adviser registered with the CFTC that also serves as an investment adviser to any private fund still qualifies for the exemption unless, after the date of the enactment of the Act, the business of the adviser should become predominantly the provision of securities-related advice.

Establishment of Exemption for Advisers to Small Business Investment Companies

The Act adds an exemption from registration for any investment adviser, other than one which has elected to be a BDC, who solely advises certain small business investment companies.

Exclusion of Family Offices

The Act excludes any family office, as defined by rule, regulation or order of the SEC, from the definition of "investment adviser" under the Advisers Act, thereby excluding family offices from the registration, record-keeping and reporting requirements of the Advisers Act. There is no deadline on the SEC defining the term "family office," but the SEC is directed to define it consistently with the previous policy of the SEC for granting exemptive relief for family offices, recognizing the range of organizational, management and employment structures and arrangements employed by family offices. The Act also excludes any person who was not registered or required to be registered under the Advisers Act as of January 1, 2010 solely because the person provides investment advice (and was engaged before January 1, 2010 in providing investment advice) to (i) natural persons who, at the time of their applicable investment, are officers, directors or employees of the family office who (a) have invested with the family office before January 1, 2010 and (b) are "accredited investors" as defined in Regulation D under the Securities Act of 1933, as amended, or the successors-in-interest thereto, (ii) any company owned exclusively and controlled by members of the family of the family office, or as the SEC may prescribe by rule, (iii) any investment adviser registered under the Advisers Act that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represent, in the aggregate, not more than 5% of the value of the total assets as to which the family office provides investment advice.

Effective Increase of Minimum AUM Required for Registration from $25 million to $100 million

The Act does not require investment advisers (i) required to be registered as an investment adviser with the State in which it maintains its principal office and place of business, which registration subjects such adviser to examination and (ii) with AUM of $25 million to $100 million (or such higher amount as the SEC may deem appropriate), to register under the Advisers Act unless such investment adviser (a) is an adviser to an investment company registered under the Investment Company Act, (b) has elected to be a BDC (and has not withdrawn its election) or (c) is otherwise required to register with 15 or more States.

Record-Keeping, Reporting And Custody Requirements

Collection of Systemic Risk Data

The Act permits the SEC to add to the existing record-keeping and reporting obligations of registered investment advisers the requirements (i) to maintain such records, and file with the SEC such reports, regarding private funds advised by the investment adviser as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Council and (ii) to provide and make available to the Council those reports or records or the information contained therein. Such information includes, for each private fund, a description of: (a) the amount of assets under management and use of leverage, including off-balance sheet leverage; (b) counterparty credit risk exposure; (c) trading and investment positions; (d) valuation policies and practices of the fund; (e) types of assets held; (f) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors; (g) trading practices; and (h) such other information as the SEC deems necessary and appropriate, which may include the establishment of different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised. Such records are required to be maintained for however long the SEC deems necessary and appropriate and copies of such records will need to be made available to the SEC without undue effort, expense or delay, as reasonably requested by the SEC or its representatives.

Periodic and Special Examinations

The Act permits the SEC to conduct periodic and, in its discretion, special examinations of the records of private funds maintained by registered investment advisers.

Information Sharing with the Council

The Act requires the SEC to make available to the Council copies of all reports, documents, records and information filed with or provided to the SEC by a registered investment adviser with respect to a private fund as the Council may consider necessary for the purpose of assessing the systemic risk posed by such private fund.

Confidentiality of Information Shared

The Act requires the Council to maintain the confidentiality of all such information received. The SEC and the Council are not able to be compelled to disclose any report or information required to be filed with the SEC, unless doing so requires the SEC or the Council, as applicable, to withhold information from Congress, upon an agreement of confidentiality, or prevents the SEC or the Council, as applicable, from complying with (i) a request for information from any other federal department or agency or any self-regulatory organization ("SRO") requesting the information for purposes within the scope of its jurisdiction or (ii) an order of a US court in an action brought by the United States or the SEC. Any department, agency or SRO that receives reports or information of a registered investment adviser to a private fund from the SEC is required to keep such reports and information confidential to the same extent as the SEC. The SEC, the Council and any department, agency or SRO that receives such reports or information are exempt from FOIA with respect to such information.

Proprietary Information

Under the Act, proprietary information of an investment adviser ascertained by the SEC from any report required to be filed with the SEC is subject to the same limitations on public disclosure as any facts ascertained during an examination, as provided for under the Advisers Act. Such proprietary information is deemed to include sensitive, nonpublic information regarding (i) the investment or trading strategies of the investment adviser, (ii) analytical or research methodologies, (iii) trading data, (iv) computer hardware or software containing intellectual property and (v) any additional information that the SEC determines to be proprietary.

Annual Report to Congress

The Act requires the SEC to report annually to Congress on how the SEC has used the data collected to monitor the markets for the protection of investors and the integrity of the markets.

Delegation to the SEC

In addition to the above noted provisions that delegate certain rule-making authority to the SEC and to the general rule-making authority of the SEC under the Advisers Act, the Act specifically authorizes the SEC to make, issue, amend and rescind such rules and regulations defining technical, trade and other terms used under the Advisers Act.

Anti-fraud Rule

Notwithstanding the SEC's broad rule-making authority, the Act prevents the SEC from extending the scope of the existing anti-fraud rule of the Adviser's Act to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser.

CFTC and SEC Coordination

The Act requires the SEC and the CFTC to promulgate rules jointly, within 12 months of the Act's enactment, after consultation with the Council, to establish the form and content of the report required to be filed under the Advisers Act by investment advisers registered under both the Advisers Act and the Commodity Exchange Act.

Custody of Client Accounts

The Act requires registered investment advisers to take such steps to safeguard client assets over which such adviser has custody, including, without limitation, verification of such assets by an independent public accountant, as the SEC may, by rule, prescribe. The SEC already promulgates such rules under the anti-fraud provisions of the Advisers Act.

Accredited Investor Standard

The Act empowers the SEC to adjust the "accredited investor" standard, which is set forth in Rules 215 and 501 of the Securities Act of 1933, as amended (the "Securities Act"), although it should be noted that the Act only cites Rule 215. By way of background, an issuer seeking an exemption from the registration requirements of the Securities Act for a private offering may rely on the safe harbor provided by Regulation D contained in Rules 501-508 promulgated under the Securities Act. The definition of "accredited investor" is a key element of the Regulation D safe harbor, as a private offering may be to an unlimited number of accredited investors (though sponsors are effectively capped at 499 investors to avoid certain requirements under the Securities Exchange Act of 1934, as amended) and most Regulation D offerings are made exclusively to accredited investors due to the onerous information required to be provided to any non-accredited investors (who are capped at 35 in any event). The "accredited investor" standard is meant to reflect investors who are presumed to be sophisticated or who have a high net worth.

Included in the existing definition of "accredited investor" is any natural person who has an individual net worth (or joint net worth with such person's spouse) of over $1 million. The Act requires the SEC to adjust the net worth standard so that the individual net worth of any natural person, or joint net worth with the spouse of that person, at the time of purchase, is over $1 million (as such amount is adjusted periodically by the SEC), excluding the value of such natural person's primary residence, except that, upon enactment of the Act, such net worth standard excluding the primary residence is $1 million.

An "accredited investor" also currently includes any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with such person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year. The Act permits the SEC to review the definition of "accredited investor" as applied to natural persons to determine whether the income standard should be adjusted or modified for the protection of investors, in the public interest and in light of the economy. After such review, the SEC is empowered, by notice and comment rulemaking, to make such adjustments to the definition "accredited investor" as it deems appropriate (though it may not make any modifications to the net worth standard described above).

The SEC is compelled to review the entire defined term "accredited investor" once every 4 years and, thereupon, by notice and comment rulemaking, make such adjustments to the term as it deems appropriate.

GAO and SEC Studies

Custody Rule Costs

The Act requires the GAO to conduct a study on the compliance costs associated with the Advisers Act rules regarding custody of funds or securities of clients by investment advisers and the additional costs if the rules relating to operational independence were eliminated. Such study is required to be completed, and a report submitted to Congress, within 3 years of the Act's enactment.

Accredited Investor Criteria

The Act requires the GAO to conduct a study on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds within three years of the Act's enactment.

SRO to Oversee Private Funds

The Act requires the GAO to conduct a study on the feasibility of forming an SRO to oversee private funds within one year of the Act's enactment.

Short-Selling

The Act requires the SEC to conduct a study on the state of short-selling on national securities exchanges and in over-the-counter markets within two years of the Act's enactment. The Act requires the SEC to conduct a study on the feasibility, costs and benefits of requiring the public reporting of real-time short sales positions of publicly listed securities or reporting such short positions in real time only to the SEC and the Financial Industry Regulatory Authority within one year of the Act's enactment. The Act requires the SEC to conduct a study on the feasibility, costs and benefits of conducting a voluntary pilot program in which public companies agrees to have all trades of their shares marked "short," "market-maker short," "buy," "buy-to-cover" or "long" and reported in real time within one year of the Act's enactment.

Adjustments for Inflation

The Act requires the SEC to index for inflation the dollar amount measures to determine who is a qualified client for purposes of paying a performance fee to a registered investment adviser. It also calls for a rounding to the nearest $100,000 when making such determination.

Effectiveness

Title IV becomes effective one year after the date of enactment.

Title V.
Insurance

Subtitle A—Federal Insurance Office

Subtitle A seeks to improve the system of insurance regulation by focusing on mitigation of systemic risk with respect to insurance and bridging gaps in insurance regulation. The title seeks to accomplish this by: (i) establishing the Federal Insurance Office; and (ii) facilitating international coordination of insurance regulation through prudential measures.

Federal Insurance Office

Section 502 establishes a Federal Insurance Office (the "Office") within the Department of Treasury, headed by a Director (the "Director") to be appointed by the Secretary of Treasury (the "Secretary") and amends Title 31 of the United States Code by adding Section 313 Federal Insurance Office. Section 313 (d) defines the scope of the Office's authority to cover all lines of insurance except: health insurance, human services, long term care insurance not included with life or annuity insurance components and crop insurance. The role of the Office will not include any general supervisory or regulatory authority over the business of insurance, and its establishment does not limit the authority of any other financial regulatory agency.

Functions of the Office

An "insurer" includes any person engaged in the business of insurance, including reinsurance.

An "affiliate," with respect to an insurer, is any person who controls, is controlled by, or is under common control with the insurer.

Section 313(c) authorizes the Office to advise the Secretary and the Financial Stability Oversight Council on domestic and international prudential insurance policy issues, and at the direction of the Secretary to:

- monitor the insurance industry generally, including identifying any issues or gaps in the regulation of insurers that may pose a systemic risk to the national insurance industry or the financial system;
- recommend to the Financial Stability Oversight Council that it designate an insurer and its affiliates to be subject to regulation as a nonbank financial company pursuant to Title I of the Act;
- develop federal policy on prudential aspects of international insurance matters, participate in the International Association of Insurance Supervisors and assist the Secretary to negotiate International Insurance Agreements on Prudential Measures (written bilateral or multilateral agreements entered into between the United States and a foreign government, authority, or regulatory entity regarding prudential measures applicable to the business of insurance or reinsurance);
- consult with the States and their insurance regulators regarding insurance matters, including prudential insurance matters, of national importance; and
- perform any other duties assigned by the Secretary.

Information Gathering Authority

Section 313(e) authorizes the Office to collect information required to perform its duties, including through information sharing agreements, and to require insurers and their affiliates (except for small insurers which do not meet a minimum size threshold to be determined by the Office) to submit data and information which is not otherwise available publicly or through an alternative source. Any confidentiality provisions of such non-public information will be preserved.

International Insurance Agreements and Preemption of State Insurance Measures

The Director may, in accordance with Section 313(f), determine that a State insurance measure is preempted for being inconsistent with an International Insurance Agreement on Prudential Measures or treats non-United States insurers subject to an international insurance agreement less favorably than a domestic insurer. However, it will not otherwise affect State insurance measures governing insurer's rates, premiums, underwriting, sales practices or coverage requirements.

Consultation with States and Retention of Existing State Regulatory Authority

The Director will consult with State insurance regulators individually or collectively in performing the functions of the Office. Further, the functions of the office do not include any general supervisory or regulatory authority over the business of insurance, and States will retain general regulatory authority over the insurance industry.

Studies and Reports

In addition to functions of the Office listed above, Section 313(n) states that the Director will submit certain reports on actions taken by the Office, the insurance industry, improvements and recommendations on insurance regulation and the global reinsurance market and its affect on insurance in the US to the President and/or the Committees on Financial Services and Ways and Means of the House of

Representatives and the Committees on Banking, Housing and Urban Affairs and Finance. In preparing such reports and related studies, the Director should consider systemic risk regulation, capital standards, consumer protection, national uniformity and international coordination. Section 313(n) provides that the study and report on improving insurance regulation should additionally examine the potential costs and benefits of Federal regulation of insurance, including:

- the potential to minimize regulatory arbitrage;
- the feasibility of Federal regulation of only certain lines, leaving other lines to state regulation;
- the impact of developments in foreign insurance regulations on potential Federal regulation; and
- potential consequences of subjecting insurance companies to a Federal resolution authority, including any impact on State insurance guaranty fund systems, policyholder protection and the international competitiveness of insurance companies.

Covered Agreements on Prudential Measures

Section 314 generally authorizes the Secretary and the United States Trade Representative to jointly negotiate international covered agreements relating to prudential measures on behalf of the United States, as long as they first consult with the Committees on Financial Services and Ways and Means of the House of Representatives and the Committees on Banking, Housing and Urban Affairs and Finance of the Senate.

Subtitle B—State-Based Insurance Reform

Subtitle B seeks to reform insurance regulation of nonadmitted insurance and reinsurance through setting uniform measures, streamlining standards, and clarifying the governing State law in the reporting, payment, and allocation of premium taxes, licensing surplus lines brokers and regulating credit for reinsurance and reinsurer solvency.

Nonadmitted Insurance

Nationwide System of Premium Taxes

Congress intends that each State adopt uniform nationwide requirements and procedures for the report, payment, collection, and allocation of premium taxes on nonadmitted insurance. Section 521 seeks to grant the authority to require payment of premium tax for nonadmitted insurance exclusively to home States, while procedures are to be established to allocate the premium taxes paid to an insured's home State among States, including a tax allocation report to be filed annually by brokers and insureds with independently procured insurance with their home State indicating the premiums attributable to properties or exposures in each State.

- The term "home State" refers generally to the State in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence. If 100 percent of the insured risk is located out of such State, then it refers to the State to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.
- The term "nonadmitted insurance" means any property and casualty insurance placed directly or through a broker with a nonadmitted insurer eligible to accept such insurance.

Regulation of Nonadmitted Insurance by the Insured's Home State

Section 522 grants exclusive authority to the insured's home State to regulate the placement of nonadmitted insurance as well as the licensing of the surplus lines brokers who sell or negotiate insurance with such insured; and further, deems the laws or regulations of any other States to be preempted with respect to the insured (except for any restrictions on the placement of workers' compensation insurance with a nonadmitted insurer).

Participation in National Producer Database

After the expiration of the two-year period beginning on the date of the enactment of the Act, Section 523 prohibits a State from collecting fees relating to the licensing of surplus lines brokers unless the State has laws or regulations that provide for its participation in the national insurance producer database of the National Association of Insurance Commissioners ("NAIC"), or an equivalent database for the issue and renewal of surplus lines brokers' licenses.

Uniform Standards

Section 524 goes on to require States to adopt nationwide uniform eligibility requirements for nonadmitted insurers, and to prohibit surplus lines brokers from dealing with nonadmitted insurers listed on the Quarterly Listing of Alien Insurers maintained by the NAIC.

Streamlined Application for Commercial Purchasers

Surplus lines brokers seeking to place nonadmitted insurance for an exempt commercial purchaser are not required to make a due diligence search to determine whether the insurance sought could be obtained by admitted insurers if:

- the broker has disclosed to the exempt commercial purchaser that the insurance may or may not be available from the more regulated admitted market and may provide greater protection; and
- the exempt commercial purchaser requests in writing for the broker to place such insurance from a nonadmitted insurer after receiving the disclosure.

Study on the Effects on the Nonadmitted Insurance Market

Section 526 requires the GAO of the United States to conduct a study of the nonadmitted insurance market to determine the effects of this subtitle B on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market. The GAO will consult with the NAIC in conducting the study to analyze:

- the change in the size and market share of the nonadmitted insurance market and in the number of insurance companies providing such business in the 18-month period that begins upon the effective date of this subtitle B;
- any shift in coverage from the admitted insurance market to the nonadmitted insurance market;
- the consequences of any change in the size and market share, including differences in the price and availability of coverage available in both the admitted and nonadmitted insurance markets;
- any shift in the volume of business between admitted and nonadmitted insurance for insurance companies that provide both admitted and nonadmitted insurance; and

- the extent of any change in the number of individuals who have nonadmitted insurance policies, the type of coverage provided under such policies, and whether such coverage is available in the admitted insurance market.

A report on the findings of the study will be submitted to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives not later than 30 months after the effective date of this subtitle B.

Reinsurance Regulation

Credit for Reinsurance, Reinsurance Agreements and Preemption of Extraterritorial Application of State Law

- A "ceding insurer" refers to an insurer that purchases reinsurance.
- The "domiciliary State" is the State in which the insurer or reinsurer is incorporated or licensed.
- Generally, "reinsurance" means the assumption by an insurer of all or part of a risk undertaken originally by another insurer.
- A "reinsurer" is an insurer that (i) is principally engaged in the business of reinsurance; (ii) does not conduct significant amounts of direct insurance; and (iii) is not engaged in the business of soliciting direct insurance.

Section 531 states that if the domiciliary State of a ceding insurer is NAIC-accredited, or has financial solvency requirements similar to those necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other State may deny such credit for reinsurance. Further, all laws, regulations, provisions, or other actions of a State that is not the domiciliary State of the ceding insurer, except those with respect to taxes on insurance income, are preempted where they:

- restrict the rights of the ceding insurer to resolve disputes through contractual arbitration;
- require that a certain State's law governs the reinsurance contract, disputes arising from the reinsurance contract, or requirements of the reinsurance contract;
- attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract; or
- otherwise apply the laws of the State to reinsurance agreements of ceding insurers not domiciled in that State.

Regulation of Reinsurer Solvency

Section 532 proposes that in regulating the financial solvency of a reinsurer, if the domiciliary State of the reinsurer is NAIC-accredited or has financial solvency requirements similar to the requirements necessary for NAIC accreditation, then the laws of the domiciliary State governs exclusively. Further, if the domiciliary State of a reinsurer is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, then no other State may require the reinsurer to provide any information in addition to the information already required by the domiciliary State. A State other than the domiciliary State of a reinsurer may receive a copy of any financial statement filed with its domiciliary State.

Title VI. Bank Holding Company Regulatory Enhancements

Bank Holding Company Regulatory Enhancements

Moratorium and Study on ILCs, Credit Card Banks and Certain Trust Companies

The Act defines the term "commercial firm" as any company whose consolidated annual gross revenues derived from financial and banking activities represent less than 15 percent of the total consolidated annual gross revenues of the company. The Act imposes a three-year moratorium on approval of FDIC insurance applications by industrial loan companies ("ILCs"), credit card banks, and certain trust companies ("trust banks") that are directly or indirectly owned or controlled by a commercial firm. Further, during the three-year moratorium, the appropriate federal banking agency may not approve a change in control of an ILC, credit card bank, or a trust bank if it results in the target being owned or controlled, directly or indirectly, by a commercial firm, unless: (i) the target institution is in danger of default; (ii) the transaction entails the bona fide merger or acquisition of one commercial firm with or by another commercial firm; or (iii) the change in control results from an acquisition of voting shares of a publicly traded company if, after the acquisition, the acquiring shareholder (or group of shareholders acting in concert) holds less than 25 percent of any class of the voting shares of the company.

ILCs, credit card banks, trust banks and savings associations are currently exempted from the definition of a "bank" under the BHCA and their holding companies are not regulated as BHCs. Within 18 months of enactment of the Act, the GAO shall conduct a study to determine whether it is necessary to eliminate the exemption from the BHCA definition of a "bank" for such institutions. The study, among other things, shall: (i) determine the adequacy of the federal bank regulatory framework applicable to these institutions, including any inter-affiliate transaction restrictions; and (ii) evaluate the potential consequences of subjecting these institutions to the requirements of the BHCA, including with respect to the availability and allocation of credit, the stability of the financial system and the economy, the safe and sound operation of each category of institution, and the impact on the types of activities in which such institutions, and the holding companies of such institutions, may engage.

"The Act generally expands the examination powers of the Federal Reserve with respect to functionally regulated subsidiaries."

Reports and Examinations of Functionally Regulated Subsidiaries

Currently, the BHCA provides that if the Federal Reserve requires a report to fulfill its supervisory responsibilities from a "functionally regulated subsidiary" of a BHC that is not required by another regulator, the Federal Reserve shall first request such report from the appropriate functional regulator. The Act eliminates this provision and would allow the Federal Reserve to obtain such reports directly from the functionally regulated subsidiary. The Act also authorizes the Federal Reserve to obtain reports from subsidiaries of a BHC (other than a depository institution or functionally regulated subsidiaries) for the purposes of monitoring compliance with applicable provisions of any federal law (not just laws that the Federal Reserve has specific jurisdiction to enforce). Functionally regulated subsidiaries include registered broker-dealers, investment advisers, investment companies, and insurance companies.

The Act also generally expands the examination powers of the Federal Reserve with respect to functionally regulated subsidiaries. In addition to the Federal Reserve's existing authority to examine any subsidiary of a BHC to assess safety and soundness risks to the BHC and any depositary institution subsidiaries of the BHC, the Act authorizes the Federal Reserve to examine any subsidiary of a BHC to obtain information concerning any risks within the bank holding company system that may pose a threat to the US financial system. The Federal Reserve is also currently authorized to examine bank holding companies and their subsidiaries for compliance with the BHCA and any other federal law that the Federal Reserve has specific jurisdiction to enforce. The Act expands this authority to include examination for compliance with any applicable federal law (not just those that the Federal Reserve has specific jurisdiction to enforce). With respect to insured depository institutions or functionally regulated subsidiaries, however, the Federal Reserve's examination authority continues to be limited to monitoring compliance with federal laws that the Federal Reserve has specific jurisdiction to enforce.

Currently the BHCA requires the Federal Reserve to forego, to the fullest extent possible, an examination of a functionally regulated subsidiary and to review instead examination reports prepared by the appropriate functional regulator. Pursuant to the Act the Federal Reserve is no longer required "to forgo, to the fullest extent possible," an examination, but shall provide reasonable notice and consult with the relevant functional regulator prior to commencing an examination and shall, to the fullest extent possible, rely on existing reports and avoid duplication of examination activities and reporting requirements.

The Act also eliminates the current limitations under Section 10A of the BHCA on the rulemaking, prudential, supervisory, and enforcement authority of the Federal Reserve with respect to functionally regulated subsidiaries of BHCs. The Act provides the Federal Reserve with the same authority to regulate and examine SLHC and their subsidiaries, including functionally regulated subsidiaries, as is conferred to the Federal Reserve with respect to BHCs under the BHCA.

New Factor in Bank and Non-Bank Acquisitions

When reviewing proposals by BHCs to merge with or acquire other banking organizations or nonbank entities, the Federal Reserve is required to consider the extent to which such mergers or acquisitions will increase the risks to the stability of the US banking or financial system.

Prior Approval for Certain Acquisitions of Financial Assets

Currently, a BHC that is or is treated as a financial holding company ("FHC") may generally engage in financial activities without the prior approval of the Federal Reserve. The Act requires prior Federal Reserve approval for any transaction in which the total consolidated assets to be acquired by an FHC exceed $10 billion (such transactions, however, are not subject to the antitrust review that is generally conducted in connection with acquisition applications by BHCs).

Supervision of Non-Functionally-Regulated Holding Company Subsidiaries

The Act provides that the Federal Reserve shall examine the activities of a non-depository institution subsidiary (other than a functionally regulated subsidiary or a subsidiary of a depository institution) of a depository institution holding company in the same manner, subject to the same standards, and with the same frequency as is required if such activities were conducted in the lead insured depository institution. The Federal Reserve shall consult and coordinate such examinations with any State regulator supervising such non-depository institution subsidiaries.

The appropriate federal banking agency for the lead depository institution of a depository institution holding company may recommend, in writing, that the Federal Reserve conduct an examination of a non-depository institution subsidiary as prescribed in the Act. If the Federal Reserve fails to: either (i) commence such examination within 60 days of such recommendation; or (ii) provide a written explanation addressing the concerns of the appropriate federal banking agency, the appropriate federal banking agency may conduct such an examination to determine whether the activities of such subsidiaries: (A) present safety and soundness risks to any depository institution subsidiary of the depository institution holding company; (B) are conducted in accordance with applicable Federal law; and (C) are subject to appropriate systems for monitoring and controlling the financial, operating, and other material risks of the activities that may pose a material threat to the safety and soundness of the depository institution subsidiaries of the holding company.

The appropriate federal banking agency for the lead depository institution of a depository institution holding company may recommend, in writing, that the Federal Reserve take enforcement action against a non-depository institution subsidiary. If the Federal Reserve does not take an enforcement action satisfactory to the appropriate federal banking agency within 60 days from receiving the recommendation, the appropriate federal banking agency may take the recommended enforcement action as if the non-depository institution subsidiary were an insured depository institution.

Well Managed and Well Capitalized Requirement for FHCs, SLHCs, and Certain Transactions

Currently, BHCs may qualify for FHC status that permits them to engage in an expanded range of financial activities if their depository institution subsidiaries are well capitalized and well managed. The Act requires the FHC itself to meet the well capitalized and well managed criteria. The Act also imposes identical requirements on SLHCs.

The Act also requires BHCs seeking to make interstate bank acquisitions to meet the well capitalized and well managed criteria. A bank resulting from an interstate merger would also have to be well capitalized and well managed for the merger transaction to receive regulatory approval.

Amendments to Inter-Affiliate Transaction Restrictions

Definition of "Affiliate"

Currently, Section 23A of the Federal Reserve Act ("FRA") provides that an "affiliate" includes: (i) any company that is sponsored and advised on a contractual basis by the member bank or any of its affiliates; and (ii) any investment company with respect to which a member bank or any of its affiliates is an investment advisor as defined in Section 2(a)(20) of the Investment Company Act of 1940. The Act amends these provisions with a provision that simply states that an "affiliate" includes "any investment fund with respect to which a member bank or affiliate thereof is an investment adviser." In addition to the current Section 23A provisions concerning the treatment of sponsored and advised companies and investment companies as affiliates, Regulation W, which implements Section 23A, provides that the term affiliate includes any other investment fund for which the member bank or any of its affiliates serves as an investment adviser, if the member bank and its affiliates own or control more than 5 percent of any class of voting securities or of the equity capital of the fund. The amendment to Section 23A appears to be intended to: (i) eliminate the 5 percent ownership requirement in Regulation W for a fund advised by a member bank or its affiliates to be treated as an affiliate; and (ii) clarify that advising a fund is sufficient for the fund to be deemed to be an affiliate (it is not necessary for the bank or its affiliates to have sponsored the fund or to have contractual or other specific arrangements or relationships with the fund).

Definition of a "Covered Transaction"

The Act amends the definition of a "covered transaction" to indicate that

"The Act expands the definition of a "covered transaction" to include securities borrowing and lending transactions and derivative transactions with an affiliate to the extent that such transactions cause the bank or its subsidiaries to have a credit exposure to the affiliate. Moreover, the Act subjects such transactions to the collateral requirements of Section 23A."

repurchase agreements are a form of an extension of credit. This amendment subjects repurchase agreements to the collateralization requirements of Section 23A. Currently, repurchase agreements between a bank and its affiliates are subject to the quantitative and qualitative requirements of Section 23A but are not subject to the mandatory collateral requirements.

The Act also expands the definition of a "covered transaction" to include securities borrowing and lending transactions and derivative transactions with an affiliate to the extent that such transactions cause the bank or its subsidiaries to have a credit exposure to the affiliate. Moreover, the Act subjects such transactions to the collateral requirements of Section 23A. Furthermore, the Act extends the collateral requirements of Section 23A to any "credit exposure" to an affiliate.

Authority to Grant Exemptions

The Act eliminates the current authority of the Federal Reserve to exempt transactions by any bank with its affiliates from the requirements of Section 23A by order. The Federal Reserve retains its current authority to provide an exemption by regulation from the requirements of Section 23A and B if it finds that such exemption is in the public interest and consistent with the purposes of Section 23A or 23B, however, the Act essentially grants the FDIC a veto power over any such exemptions. The Federal Reserve is authorized, however, to exempt by order inter-affiliate transactions of state member banks if it finds jointly with the FDIC that the exemption is in the public interest and consistent with the purposes of Section 23A and the FDIC finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund. In the case of national banks and federal savings associations, the OCC is authorized to provide exemptions by order from the inter-affiliate transaction requirements of Section 23A if it finds jointly with the Federal Reserve that the exemption is in the public interest and consistent with the purposes of Section 23A and the FDIC does not object on the basis that the exemption presents an unacceptable risk to the Deposit Insurance Fund. Similarly, in the case of state non-member banks and state savings associations the FDIC is authorized to exempt transactions by order after a joint finding with the Federal Reserve that the transaction is in the public interest and consistent with the purposes of Section 23A and that the exemption does not present an unacceptable risk to the Deposit Insurance Fund.

Treatment of Netting Arrangements

The Act authorizes the Federal Reserve to issue regulations or interpretations with respect to the manner in which netting agreements between banks and their affiliates may be taken into account in determining the amount of covered transactions. Such an interpretation will be issued jointly with the appropriate federal banking agency for the respective bank or affiliate.

Financial Subsidiaries

Currently, although subsidiaries of banks are generally not treated as affiliates for purposes of the inter-affiliate transaction restrictions of Section 23A, financial subsidiaries of banks are treated as affiliates. Nonetheless, Section 23A does not impose the individual quantitative limit on covered transactions between a bank and any of its financial subsidiaries (i.e., transactions between a bank and any of its financial subsidiaries are not limited to less than 10 percent of the bank's capital and surplus). The Act eliminates this exemption and transactions between a bank and any of its financial subsidiaries are fully subject to the requirements of Section 23A and B.

Lending Limits Coverage

Currently, the total loans and extensions of credit by a national bank to a person are subject to certain limits. The Act expands the definition of "loans and extensions of credit" to include credit exposures to a person arising out of derivative transactions, repurchase agreements, reverse repurchase agreements, and securities lending and borrowing transactions. The Act also provides that an insured State bank may engage in a derivative transaction only if the relevant State's law with respect to lending limits takes into consideration credit exposure to derivative transactions.

"The appropriate Federal banking agencies will jointly issue rules implementing the source of strength doctrine and may require holding companies of depository institutions to report periodically for purposes of assessing the ability of the holding company to comply with the source of strength requirement."

Restriction on Conversion of Troubled Banks

The Act generally prohibits the approval of banking charter conversion applications (from state to federal and vice versa) during any period in which the institution is subject to a cease and desist order or other formal enforcement action or a memorandum of understanding issued against the institution.

De Novo Branching Into States

The Act confers to national banks and out-of-state-chartered banks the authority to establish de novo branches in a state as if the national bank or out-of-state-chartered bank were chartered in that state.

Amendments to Restrictions on Transactions with Insiders

The Act extends the application of lending limits to insiders to credit exposures arising from derivative transactions, repurchase and reverse repurchase agreements, and securities lending or borrowing transactions.

The Act provides that insured depository institutions may not purchase or sell an asset to an executive officer, director, or principal shareholder of the insured depository institution or any related interest of such a person (as those terms are defined in Section 22 of the FRA) unless: (i) the transaction is on market terms; and (ii) if the transaction exceeds 10 percent of the depository institution's capital and surplus, the transaction must be approved by majority of disinterested directors of the board of the institution. The Federal Reserve, in consultation with the OCC and the FDIC, may issue rules implementing these provisions. The existing restrictions on purchases of property between a bank and its directors or related interests in Section 22(d) of the FRA would be repealed.

Authority to Impose Capital Requirements for BHCs

Currently, the Federal Reserve requires BHCs to maintain minimum regulatory capital even though the Federal Reserve has no such explicit authority under the BHCA. The Act explicitly authorizes the Federal Reserve to implement regulatory capital requirements for BHCs and SLHC. The Act provides that in establishing capital adequacy requirements for BHCs, SLHCs, and insured depository institutions the Federal Reserve and the appropriate federal banking agencies shall seek to make such requirements countercyclical. Further, the Act codifies the Federal Reserve's long-standing "source of strength" doctrine, pursuant to which BHCs are expected to serve as a source of financial strength to their subsidiary depository institutions. The Act also imposes the source of strength requirement on any other company (other than a BHC) that controls, directly or indirectly, an insured depository institution.

The appropriate federal banking agencies shall jointly issue rules implementing the source of strength doctrine and may require holding companies of depository institutions to report periodically for purposes of assessing the ability of the holding company to comply with the source of strength requirement.

Securities Firms Holding Companies

The Act repeals the elective investment bank holding company regulatory framework, pursuant to which investment banks were able to elect to be supervised on consolidated basis by the SEC pursuant to the US Securities Exchange Act of 1934. The Act institutes an elective regulatory framework for "securities holding companies" under the authority of the Federal Reserve. The term "securities holding company" is generally defined as any legal entity that owns or controls one or more brokers or dealers registered with the SEC that is not subject to comprehensive consolidated supervision by any regulator.

The Act provides that a securities holding company that is required by a foreign regulator to be subject to comprehensive consolidated supervision may register with the Federal Reserve to become a "supervised securities holding company." The Federal Reserve may prescribe by regulation the requirements for registration.

A supervised securities holding company shall make and keep records and submit reports as required by the Federal Reserve. A supervised securities holding company is subject to the provisions of the BHCA, other than section 4 of the Act. Accordingly, a supervised securities holding company is not subject to the nonbanking activity restrictions of the BHCA but would be fully subject to the Federal Reserve's supervision and regulation powers under the BHCA. Furthermore, the Act explicitly provides that the Federal Reserve shall have examination authority over supervised securities holding companies and shall have the authority to prescribe capital adequacy and other risk management standards for such entities. The Federal Reserve shall impose such standards by regulation or order and may differentiate among supervised securities holding companies taking into consideration: (i) the differences among types of business activities carried out by the supervised securities holding company; (ii) the amount and nature of the financial assets of the supervised securities holding company; (iii) the amount and nature of the liabilities of the supervised securities holding company, including the degree of reliance on short-term funding; (iv) the extent and nature of the off-balance sheet exposures of the supervised securities holding company; (v) the extent and nature of the transactions and relationships of the supervised securities holding company with other financial companies; (vi) the importance of the supervised securities holding company as a source of credit for households, businesses, and state and local governments, and as a source of liquidity for the financial system; and (vii) the nature, scope, and mix of the activities of the supervised securities holding company. The Act also confers to the Federal Reserve the same enforcement authority with respect to supervised securities holding companies as is conferred to the Federal Reserve with respect to BHCs under the FDIA.

The Volcker Rule

The Volcker Rule generally prohibits "proprietary trading" and "sponsoring" or acquiring of any ownership interest in "private equity funds" or "hedge funds" by insured depository institutions, insured depository institution holding companies, BHCs, and their affiliates (collectively "banking entities"). NBFCs engaged in such activities will be subject to certain additional capital requirements and quantitative limits, except that such additional capital requirements and quantitative limits shall not apply with respect to proprietary transactions or hedge or private fund-related activities that are exempted from the provisions of the Volcker Rule.

The Council is tasked to complete a study no later than six months after enactment of the Act and to make recommendations on implementing the provisions of the Volcker Rule. The appropriate federal banking agencies, the SEC, and the CFTC will consider the findings of the study and will promulgate jointly implementing regulations no later than nine months after the date of the completion of the study by the Council.

"The Act provides that a securities holding company that is required by a foreign regulator to be subject to comprehensive consolidated supervision may register with the Federal Reserve to become a supervised securities holding company. A supervised securities holding company is subject to the provisions of the BHCA, other than section 4 of the Act."

"The Volcker Rule generally prohibits "proprietary trading" and "sponsoring" or acquiring of any ownership interest in "private equity funds" or "hedge funds" by insured depository institutions, insured depository institution holding companies, BHCs, and their affiliates."

The Act explicitly provides that such rules will impose additional capital requirements and quantitative limitations, including diversification requirements, regarding any proprietary trading activities or hedge or private fund-related activities that are exempted from the provisions of the Volcker Rule if deemed to be appropriate to protect the safety and soundness of banking entities engaged in such activities.

The Volcker Rule provisions will become effective on the earlier of 12 months after the issuance of implementing regulations or 2 years after the Act's enactment. The Act provides for a transition period of two years (with the possibility of up to three one-year extensions) after the effective date of the Volcker Rule provisions for banking entities to bring their operations into compliance with the relevant regulatory requirements. With respect to investments in "illiquid funds" the Federal Reserve may grant one additional extension of the compliance period for up to 5 years. An "illiquid fund" is generally defined as a hedge fund or a private equity fund that is contractually committed to invest principally in illiquid assets, such as portfolio companies, real estate and venture capital investments.

Proprietary Trading

The term "proprietary trading" is defined as engaging as a principal for the trading account of the banking entity or NBFC in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate federal banking agencies, the SEC, and the CFTC may determine by rule.

Subject to any restrictions or limitations that the appropriate federal banking agencies, the SEC, and the CFTC may impose, the general prohibition on proprietary trading activities shall not apply with respect to: (i) the trading of obligations of the United States, obligations of any state or political subdivision of a state, and obligations of or instruments issued by Ginnie Mae, Fannie Mae, or Freddie Mac; (ii) trading of securities and other instruments in connection with underwriting or market-making-related activities; (iii) risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings; (iv) trading on behalf of customers; (v) certain trading activities by regulated insurance companies; and (vi) trading activities conducted solely outside of the United States by companies that are not directly or indirectly controlled by a company organized under US law.

The GAO will conduct a study of the risks and conflicts associated with proprietary trading by banking entities. The Act authorizes the GAO to access information necessary for producing its report, and provides (with limited exceptions) that any such information will be kept confidential. The study will evaluate whether proprietary trading presents (i) a material systemic risk to the stability of the US financial system, (ii) a material risk to the safety and soundness of the covered entities, and (iii) material conflicts of interests between such entities and clients. The study must also evaluate (i) whether adequate disclosure regarding the risks and conflicts of proprietary trading is provided to depositors, trading and asset management clients, and investors in such entities and (ii) whether banking, securities, and commodities regulators of institutions that engage in proprietary trading have adequate systems and controls to monitor and contain any risks and conflicts of interest relating to proprietary trading.

Investing in, Sponsoring, and Managing Private Equity and Hedge Funds

The terms "private equity fund" and "hedge fund" shall mean an entity exempt from registration as an investment company pursuant to Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, or a similar fund as jointly determined by the appropriate Federal banking regulators. The term to "sponsor" a fund is defined in the Act as: (i) serving as a general partner, managing member, or trustee of the fund; (ii) selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the fund's directors, trustees, or management of the fund; or (iii) sharing the same name, or a variation thereof, with the fund for corporate, marketing, promotional, or other purposes.

Subject to any restrictions or limitations that the appropriate federal banking agencies, the SEC, and the CFTC may impose, the general prohibition on "sponsoring" or investing in "private equity funds" or "hedge funds" will not apply to: (i) investments in small business investment companies, as that term is defined in section 103 of the Small Business Investment Act of 1958; (ii) investments designed to promote the public welfare; (iii) an investment made solely outside the United States provided that the company making the investment or conducting the activity is not directly or indirectly owned or controlled by a company organized under US law and that no ownership interest in the target hedge fund or private equity fund is offered or sold to US residents; and (iv) organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund, provided that: (a) the fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, or investment advisory services provided by the banking entity to customers; (b) the banking entity does not acquire more than a de minimis ownership interest in the fund; (c) the banking entity does not guarantee, assume, or otherwise insure the obligations of the fund; (d) the banking entity does not share the same name or its variation with the fund; (e) no director or employee of the banking entity has an ownership interest in the fund (except for directors or employees directly engaged in providing services to the fund); and (f) the banking entity discloses to investors that any losses of the fund are borne solely by the investors and not by the banking entity.

“A banking entity would be able to make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers, provided that within a year after the establishment of the fund (with the possibility of two one-year extensions) the ownership interest of the banking entity in the fund shall be reduced through redemption, sale, or dilution to less than 3 percent of the total ownership interest in the fund. The aggregate investments by a banking entity in hedge funds or private equity funds are limited to 3 percent of Tier I capital of the banking entity.”

A banking entity will be able to make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers, provided that within a year after the establishment of the fund (with the possibility of two one-year extensions) the ownership interest of the banking entity in the fund shall be reduced through redemption, sale, or dilution to less than 3 percent of the total ownership interest in the fund. The aggregate investments by a banking entity in hedge funds or private equity funds would be limited to 3 percent of Tier I capital of the banking entity.

Banking entities may continue to serve as investment adviser or manager to a hedge fund or a private equity fund. However, the Act prohibits a banking entity or NBFC that organizes or has an affiliate that serves as an investment manager or adviser of a hedge fund or private equity fund from entering into covered transactions, as defined in section 23A of the FRA, with such hedge fund or private equity fund. Notwithstanding the limitation stated above, the Federal Reserve may permit a banking entity or a NBFC to enter into any prime brokerage transaction with any hedge fund or private equity fund in which a hedge fund or private equity fund managed, organized, or advised by such banking entity or NBFC has taken an equity, partnership, or other ownership interest, provided that certain conditions are met. All transactions between a banking entity or NBFC with an affiliate that serves as an investment manager or adviser of a hedge fund or private equity fund and such fund shall be subject to section 23B of the FRA and shall be on market terms.

“The Act permits the appropriate Federal banking agencies, the SEC, and the CFTC to exempt by rule from the provisions of the Volcker Rule any activity the agencies determine promotes and protects the safety and soundness of the banking entity or NBFC and the financial stability of the United States.”

The Act permits the appropriate federal banking agencies, the SEC, and the CFTC to exempt by rule from the provisions of the Volcker Rule any activity the agencies determine promotes and protects the safety and soundness of the banking entity or NBFC and the financial stability of the United States.

No transaction or activity that may fall within an exemption from the provisions of the Volcker Rule shall be permitted if the transaction or activity: (i) involves material conflict of interest between the banking entity and its clients or counterparties; (ii) results in an unsafe or unsound exposure; (iii) poses a threat to the safety and soundness of the banking entity; or (iv) poses a threat to the financial stability of the United States.

Concentration Limits

Subject to recommendations by the Council, a financial company may not merge or consolidate with another company if the total consolidated liabilities of the acquiring company upon consummation of the transaction exceed 10 percent of the aggregate consolidated liabilities of all financial companies as of the year end preceding the transaction. This limit shall not apply to: (i) an acquisition of a bank in default or in danger of default or receiving FDIC assistance; or (ii) a transaction that results only in de minimis increase of the liabilities of the financial company.

"The Act repeals the prohibition on payment of interest on demand deposits. The repeal of the prohibition shall take effect one year after enactment of the Act."

For purposes of the concentration limits the term "financial company" is defined as: (i) insured depository institution; (ii) any company that controls an insured depository institution; (iii) NBFC; and (iv) foreign bank or company treated as a BHC. The Act defines the term "liabilities" as the total risk-weighted assets of the financial company less the total regulatory capital of the company (foreign-based financial companies must count only risk-based assets and capital of their US operations). The Federal Reserve shall issue regulations implementing the concentration limit provisions and may issue interpretations or guidance regarding the application of such limits to individual financial companies.

Currently, the BHCA contains a deposit cap on interstate acquisitions of banks by BHCs. Section 3 of the BHCA provides that the Federal Reserve may not approve an acquisition by a BHC of a bank with a home state other than the home state of the BHC if the acquirer BHC controls, or upon consummation of the transaction controls more than 10 percent of the total amount of deposits of insured depository institutions in the United States (the "10 percent deposit cap"). The Act extends the 10 percent deposit cap with respect to: (i) interstate bank merger transactions; (ii) interstate acquisitions by BHCs of insured depository institutions that are not "banks" under the BHCA's definition of a "bank;" and (iii) interstate acquisitions of insured depository institutions by SLHCs. The 10 percent deposit cap shall not apply to an acquisition of an insured depository institution in default or in danger of default or receiving FDIC assistance.

Interest-Bearing Transaction Accounts Authorized

The Act repeals the prohibition on payment of interest on demand deposits. The repeal of the prohibition shall take effect one year after enactment of the Act.

"Subject to recommendations by the Council, a financial company may not merge or consolidate with another company if the total consolidated liabilities of the acquiring company upon consummation of the transaction exceed 10 percent of the aggregate consolidated liabilities of all financial companies as of the year end preceding the transaction."

Title VII. Wall Street Transparency and Accountability

Derivatives Reform

Title VII of the Act provides for significant reforms of the over the counter (OTC) derivatives market, grants significant authority to the SEC and the CFTC to regulate derivatives and market participants and requires clearing and exchange trading of most derivatives transactions.

Definitions of Swap and Security-Based Swap

Swaps

The Act defines swaps, which will be regulated by the CFTC, as options, contingent forwards, exchanges of payment or transactions that are based on an underlying financial product, or a contract that becomes known as a swap in the market. Interest rate swaps, currency swaps, foreign exchange swaps, total return swaps and credit default swaps are explicitly defined as "swaps". The definition of swaps specifically excludes:

- contracts for sale of commodities for future delivery,
- the sale of a non-financial commodity for deferred delivery, so long as the transaction is intended to be physically settled,
- any put or call that is subject to the securities laws,
- any foreign exchange put, call or option that is traded on a national exchange,
- non-contingent sales of securities subject to the securities laws,
- contingent sales of securities not dependent on the creditworthiness of a party other than a party to the agreement,
- agreements based on a security and entered into with an underwriter for the purpose of capital raising (but not for the purpose of risk management),
- agreements with the Federal Reserve or the Federal Government and any agency thereof,
- security-based swaps, and
- certain foreign exchange contracts as described below.

Security-Based Swaps

Security-based swaps, which will be regulated by the SEC, are defined as swaps which are based on a narrow-based security index, a single security or loan and the occurrence or non-occurrence of an event relating to a single issuer of a security (or the issuers of a narrow-based security index). A narrow-based security index is generally defined as an index with nine or fewer components.

Unless the context requires otherwise, this memorandum will refer to either swaps or security-based swaps as "swaps".

Mixed Swaps/Identified Banking Products

"Mixed swaps", which have elements of both swaps and security-based swaps, will be defined jointly by the SEC and the CFTC, and will be regulated by the SEC as security-based swaps. Rules for novel swap products will be determined jointly by the SEC and the CFTC.

Identified banking products, which include deposits, letters of credit and loan participations (but not swaps), will not be regulated as swaps, unless the relevant bank regulator deems them to be swaps or the product is entered into by a bank that is not federally regulated and which is using such banking products to evade derivatives regulation.

Credit Default Swaps

Credit default swaps (CDS) are considered swaps under the Act. It appears that single name CDS, whether loan-based or security-based, are considered security-based swaps regulated by the SEC while CDS on broad portfolios are swaps but not security-based swaps, and therefore regulated by the CFTC.

Foreign Exchange

Foreign exchange options are swaps. Foreign exchange forwards and swaps are also regulated as swaps, although the Treasury Secretary may make a written determination to exempt foreign exchange forwards and swaps from regulation under the Act. Even if so exempted, foreign exchange forwards and swaps still need to be reported and remain subject to the business conduct standards applicable to swap dealers under the Act. It is not clear if cash-settled foreign exchange swaps and forwards could be exempted by the Treasury Secretary.

Commodity Swaps Intended to be Physically Settled

The definition of a swap excludes contracts for any sale of a non-financial commodity for deferred delivery so long as the transaction is intended to be physically settled. The Act does not provide any guidance as to how "intend" will be defined, and whether the treatment of a swap will change if the parties decided not to physically settle such swap on a later date.

Market Participants

Push Out Rule

The Act provides that no federal assistance may be provided to any swap dealer, major swap participant (other than any major swap participant that is an insured depository institution), swap execution facility or derivatives clearing organization. Such prohibition would not apply to a FDIC-insured depository institution that limited its swap activities to (a) hedging and other risk management activities related to its own activities, and (b) acting as a swap dealer in transactions involving rates or reference assets that a national bank may invest in. However, depository institutions are prohibited from acting as a swap dealer for credit default swaps referencing unless such swaps are cleared by a clearing organization. This permits banks to act as dealers with respect to interest rate swaps, currency swaps and certain credit default swaps.

Federal assistance is defined to include advances from the Federal Reserve and use of FDIC funds for the purposes of purchasing debt, assets or equity, guaranteeing any debt or entering into any other arrangements.

The Act provides that a depository institution may receive a period (determined by the appropriate banking regulator and the SEC or the CFTC, as applicable) of not more than 24 months to divest or spin-off its swap entity while federal assistance. The prohibition of federal assistance will be effective two years from the effective date of the Act.

Definition of Swap Dealers and Major Swap Participants

1. Dealers

The Act regulates "swap dealers" and "security-based swap dealers". (In this memorandum, "swap dealer" refers to either.) A swap dealer is any person that holds itself out as a dealer in swaps, that makes a market in swaps, regularly enters into swaps with counterparties in the ordinary course of business or its own account or engages in any activity causing it to be commonly known in the trade as a swap dealer or market maker, provided that an insured depository institution will not be considered a swap dealer if it enters into a swap with a customer in connection with originating a loan with such customer. A person may be designated as a swap dealer for a single class, type, or category of swaps and not considered to be a swap dealer for other types, classes or categories.

A swap dealer does not include a person that buys or sells swaps for its own account, but not as a part of a regular business. It seems likely, by analogy to requirements for securities dealers, that a swap dealer would not include a person who trades in swaps but does not seek to make a market or hold itself out to others as a dealer.

2. Major Swap Participants

A "major swap participant" is a person that is not a swap dealer but (a) that maintains a substantial position in swaps for any major swap category (other than for hedging or mitigating its own commercial risks and excluding positions maintained by pension plans), (b) whose outstanding positions create substantial counterparty exposure that could have serious adverse effects on the financial stability of US financial markets or (c) that is a financial entity that is highly leveraged and maintains a substantial position in any major swap category. The CFTC or the SEC, as applicable, will define the term "substantial position" at a prudent threshold for the effective monitoring, management and oversight of entities that are systemically important or can significantly impact the US financial system. The definition of major swap participant excludes any entity whose primary business is providing financing, and which uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, and 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company. (In this memorandum "major swap participant" refers to both "major swap participants" and "major security-based swap participants".)

Comment: Definition of Major Swap Participant: One critical item that remains to be determined is who will be covered by the definition of major swap participant. An entity that uses swaps to hedge commercial risk may be covered by this definition if it has significant swap positions which are not all for hedging purposes. For funds, one issue will be whether all members of a fund group with substantial swap positions must register or if there is any way of isolating the position in one fund. As the CFTC and the SEC will have significant discretion to define major swap participants, this determination may remain unclear until the final rules are released.

Extension of Scope of Regulation to Swap Dealers and Major Swap Participants

1. Registration

The Act requires all swap dealers and major swap participants to register with the CFTC (with respect to swaps) or the SEC (with respect to security-based swaps). A swap dealer or major swap participant must register with the CFTC or the SEC even if the swap dealer or major swap participant is otherwise regulated: thus, for example, a swap dealer must register with the CFTC even if the swap dealer is a US bank and is a security-based swap dealer registered with the SEC.

2. Regulatory Requirements
The Act directs the SEC and the CFTC to jointly adopt prudential requirements for swap dealers and major swap participants. However, the Act gives prudential regulatory authority to banking regulators over banks and branches of foreign banks.

3. Capital and Margin
Capital requirements will be imposed with respect to each swap entered into by a swap dealer or a major swap participant. The capital requirement for depository institutions will be set jointly by the appropriate federal agencies in consultation with the CFTC and the SEC and the capital requirement for non-depository institutions will be set by the CFTC (with respect to swap dealers and major swap participants) or the SEC (with respect to security-based swap dealers and security-based major swap participants). In addition, the capital requirements established for non-cleared swaps shall be appropriate to offset the substantially higher risk associated with non-cleared swaps.

Margin requirements for both initial and variation margin will be imposed with respect to each non-cleared swap entered into by a swap dealer or a major swap participant. The margin requirement for depository institutions will be set by the appropriate federal agency in consultation with the CFTC or the SEC, as applicable, and the margin requirement for non-depository institutions will be set by the CFTC or the SEC, as applicable, and shall be at least as strict as the capital requirement for depository institutions. In addition, the margin requirements established for non-cleared swaps shall be appropriate to offset the substantially higher risk associated with non-cleared swaps.

"Title VII of the Act introduces significant reforms to the over the counter derivatives market by granting the SEC and the CFTC authority to regulate swap dealers and major swap participants and requiring clearing and exchange trading of most derivatives transactions."

Comment: Capital for Non-Bank Major Swap Participants: It is not entirely clear how capital requirements for swaps will be imposed on major swap participants that are otherwise unregulated and that are not subject to capital requirements.

Comment: Determination of Capital Requirement: In imposing capital requirements, the CFTC shall take into account the risks associated with other types or classes of swaps engaged in and the other activities conducted by such entity that are not otherwise subject to regulation. Therefore, the capital requirements of a swap dealer or a major swap participant may be significantly greater than for the swaps which subject such entity to regulation.

Comment: Margin Determination: It is unclear how margin will be imposed on swaps. The Act mentions initial and variation margin. Customarily, variation margin relates to mark-to-market valuations of swaps and it is not clear how initial margin will be determined.

4. Business conduct rules
The CFTC or the SEC, as the case may be, will also enact business conduct rules with respect to swap dealers and major swap participants. Such rules will provide for, among other things, maintenance of records (including emails and call recordings), disclosure of risks and conflicts of interest, reporting, appointment of a chief compliance officer and the establishment of a standard of care.

5. Responsibilities to special entities
Any swap dealer or major swap participant that enters into a contract with, or advises a federal agency, state agency, city, county, municipality, pension plan or endowment must act with a heightened standard towards such counterparty. If the swap dealer or major swap participant acts as advisor to any such entity, it will be required to act in the best interest of such entity and will make a reasonable effort to ensure that any swap recommended by such advisor is in the best interests of such special entity. If the swap dealer acts as a counterparty to such entity, it will be required to disclose the capacity in which it is acting and to have reasonable basis to believe that the entity has a qualified independent advisor, which is (a) independent, (b) sufficiently knowledgeable, (c) independent of the swap dealer, (d) makes appropriate disclosures and (e) will provide written representations regarding fair pricing and the appropriateness of the transaction.

Non-US Entities

The Act does not contain explicit exemptions for non-US swap dealers or non-US major swap participants. However, provisions of the Act relating to swaps will not apply to activities outside the U.S. unless such activities contravene rules adopted by the regulators or, for swaps but not security-based swaps, have a direct effect on the US Also, if the CFTC or the SEC determine that regulation of swaps in a foreign country undermines the stability of the US financial system, the CFTC or the SEC may, in consultation with the Treasury, bar entities domiciled in such country from any swap activities in the US

There is some precedent, outside the derivatives context, for regulations governing US activities of non-US financial institutions (such as SEC Rule 15a-6 for securities activities and CFTC Part 30 for futures activities). However, the Act does not contemplate such regulations and, even if such regulations are adopted, they may significantly restrict the US activities of non-US derivatives firms.

Clearing and Execution Requirements

Central Clearing of Swaps

1. Mandatory Clearing

The Act requires all swaps to be cleared through a derivatives clearing organization regulated by the CFTC (with respect to swaps) or a securities clearing agency regulated by the SEC (with respect to security-based swaps) or a derivatives clearing organization that is exempt from registration by requiring any person that is party to a swap to submit such swap to a clearing organization. Prior to accepting any new category, type, or class of swap for clearing, a clearing organization will submit such type of swap for approval to the CFTC or the SEC, as applicable. In addition, the CFTC or the SEC, as applicable, may require the clearing of a swap that has not been requested to be cleared by any clearing organization, but may not require any clearing organization to clear a swap if the clearing of that swap adversely affects the financial integrity of the clearing organization. Swaps entered into prior to the application of the mandatory clearing requirement or prior to the passage of the Act will be exempted from the mandatory clearing requirement, although such swaps will be required to be reported. The mandatory clearing requirement shall come into force 180 days after the enactment of the Act.

2. Exemptions from Clearing

A swap is not required to be cleared if no clearing organization is willing to clear such swap. In addition, any counterparty that is (a) not a financial entity, (b) using swaps to hedge or mitigate commercial risk, and (c) notifies the CFTC or the SEC, as applicable, as to how it generally meets its financial obligations associated with entering into non-cleared swaps is not be subject to the mandatory clearing requirement. (Such counterparty may, however, request that a swap it enters into be cleared and is entitled to choose the clearing organization.)

The Act defines a financial entity as:

- a swap dealer or major swap participant,
- a person predominantly engaged in banking or financial activities,
- a commodity pool or a private fund that make use of the 3(c)(1) or the 3(c)(7) exemption from registration under the 1940 Act,
- anyone required to be registered with the CFTC or the SEC (other than a public company), or
- an employee benefit plan.

The SEC or the CFTC, as applicable, may choose to exclude from the definition of financial entity depository institutions, farm credit system institutions and credit unions with total assets up to $15 billion.

In addition, affiliates of entities exempt from the clearing requirement (including affiliates predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of such entity) may use the exemption if (a) the affiliate is acting as an agent for the exempt entity (or any other exempt entity), (b) the affiliate uses the swap to hedge commercial risk of the exempt entity; and (c) the affiliate does not fall into any of the above categories and is not a bank holding company.

Any swap that is not required to be cleared shall nevertheless be subject to reporting requirements, and must be reported to a swap data repository or the CFTC or the SEC, as applicable.

Comment: Major Swap Participants:

The Act provides that major swap participants must register with respect to a certain type, class or category of swap. However, the exemption from clearing is denied to any person that is a major swap participant. Therefore, it appears that an entity that is a major swap participant with respect to one category of swaps may not be able to use the exemption from clearing for other types of swaps. For example, an oil company that may be considered a major swap participant with respect to oil derivatives may not be able to avail itself of the exemption from clearing for interest rate swaps.

Execution of Swaps

All swaps that are required to be cleared are also required to be executed on a regulated exchange or a swap execution facility (SEF) unless no exchange or SEF is willing to list the swap. An SEF is defined as a trading system or platform that is not an exchange but that allows multiple participants to execute or trade swaps (but not other types of contracts) by accepting bids and offers made by other participants and that is open to multiple participants. Entities exempt from the clearing requirement are also exempt from the execution requirement.

Reporting of Swaps

1. Reporting by Market Participants
The Act requires each party that enters into a swap to report such swap to a swap data repository or a security-based swap data repository (in this memorandum swap data repository will refer to either), or if there is no swap data repository that accepts such a swap, to the CFTC or the SEC, as applicable.

Swaps that were entered into prior to the enactment of the Act are required to be reported to a swap data repository or the CFTC or the SEC, as applicable, within 30 days of the issuance of the final rule, which rule must be issued not later than 90 days of the enactment of the Act, or such other period as determined by the regulators. This reporting requirement is applicable to all swap participants and is not limited to swap dealers or major swap participants.

Any entity that enters into a non-cleared swap which is not accepted by a swap data repository shall be required to maintain books and records with respect to such swap in a way that the SEC or the CFTC may require, which shall be open to inspection by various regulators as well as the Department of Justice.

2. Public Reporting
The CFTC and the SEC will require real-time public reporting by clearing organizations. The CFTC and the SEC, as applicable, will also make available to the public the aggregate data on swap trading volumes and positions of swaps that are not cleared by clearing organizations but are instead reported to swap repositories or the regulators. The CFTC and the SEC will promulgate rules that ensure that such public reporting does not identify the participants.

Collateral Requirements for Swaps

If margin is provided under a non-cleared swap, the counterparty that is not a swap dealer or a major swap participant may require that the segregation of initial (but not variation) margin with a third party custodian. The regulators may permit the use of non-cash collateral if doing so is consistent with the financial integrity of the markets and the stability of the US financial system.

Only a CFTC-registered futures commission merchant will be permitted to accept and hold margin with respect to a cleared swap and only an SEC-registered broker, dealer or security-based swap dealer will be permitted to accept and hold margin with respect to a cleared security-based swap.

Regulation of Clearing Organizations, SEFs and Swap Repositories

Clearing Organizations

All derivatives clearing organizations that clear swaps must be registered with the CFTC (or with the SEC in the case of security-based swaps). Clearing agencies registered with the SEC on the date of the enactment of the Act may be deemed to be registered as a derivatives clearing organization. The CFTC may exempt SEC registered and non-US clearing organizations that are subject to similar scrutiny in their home jurisdictions and the SEC may also exempt CFTC registered and non-US clearing organizations that are subject to similar scrutiny in their home jurisdictions. Each clearing organization will be required to publicly disclose, on a daily basis, the settlement prices, volume and open interest for each settled contract. In addition, clearing organizations will be required to comply with certain core principles, including:

- maintaining adequate financial resources to withstand the default of the business participant that has the clearing organization's highest exposure and to cover its operating expenses for a year,
- maintaining appropriate admission standards for members and swaps to be cleared and ways to monitor compliance with such standards, and
- the inclusion of market participants on its governing board.

SEFs

All systems or platforms that trade or process swaps (other than CFTC-designated contract markets) must be registered as SEFs with the CFTC or with the SEC in the case of SEFs that execute trades in security-based swaps. Exchanges may also operate SEFs and may use the same electronic trade execution system, although they are required to identify whether the trading is taking place on the exchange or on the SEF. SEFs are also subject to compliance with certain core principles, including:

- establishing and enforcing trading and participation rules that will deter abuses,
- establishing trading procedures and monitoring trading to prevent manipulation, price distortion or disruption of the market,
- establishing and enforcing rules to allow the SEF to collect information, which information will be shared with

the CFTC and/or the SEC, as applicable,

- establishing position limits, which, shall be set no lower than any position limits established by the CFTC or the SEC, and
- maintaining adequate financial resources to cover its operating expenses for a year.

Comment: Contract Markets: The Act provides new "core principles" for contract markets, which are similar to the core principles of SEFs. In addition, the Act amends the Commodity Exchange Act to permit the CFTC to set margin requirements with respect to contract markets.

Comment: Ownership by Swap Dealers and Major Swap Participants: Within 180 days the CFTC will determine whether to adopt rules to limit the ownership of, or voting rights with respect to, any clearing agency, SEF or contract market by bank holding companies, swap dealers and major swap participants. The CFTC and the SEC will also adopt rules to mitigate conflicts of interest for swap dealers and major swap participants with respect to clearing agencies, SEFs and contract markets in which a swap dealer or major swap participant has a debt or equity investment.

Swap Data Repositories

The Act provides that each entity that acts as a swap data repository or a security-based swap data repository (in this memorandum, "swap data repository" refers to either) must be registered with, and will be subject to examination by, the CFTC or the SEC, as applicable, and any entity that acts as both a swap data repository and a security-based swap data repository is required to register with both commissions. Clearing organizations are permitted to register as swap data repositories. The relevant commissions will prescribe the data elements required to be collected by swap data repositories from each swap as well as data collection and maintenance standards, which standards will be similar to those imposed on clearing organizations.

Swap data repositories are required to

- accept all data required to be collected by the SEC or the CFTC, as applicable,
- confirm the accuracy of swap information with both counterparties,
- maintain swap data in the form prescribed by the SEC or the CFTC,
- provide electronic access to the SEC or the CFTC (or a designee),
- maintain privacy of swap data received, and
- establish automated systems for monitoring and analyzing swap data.

Swap data repositories are required to provide any held swap data to various regulators upon request (including foreign regulators), but only if such regulators agree to abide by the confidentiality provisions applicable to such swap data repository and agree to indemnify the swap data repository for any litigation expenses arising from the provision of any such information. Swap data repositories shall also be subject to compliance with certain core principles, including (a) not adopting any rule that is an unreasonable restraint on trade or imposes an anti-competitive burden on trading, clearing or reporting transactions, (b) establishing transparent governance arrangements that fulfill the public interest and support the aims of the Federal Government and (c) establishing conflict of interest rules.

Foreign Boards of Trade

1. General

The CFTC may require any foreign board of trade to register with the CFTC if it provides its US members with direct access to the electronic trading system of the foreign board of trade. In making its decision, the CFTC shall consider whether such foreign board of trade is subject to comparable regulation in such foreign board of trade's home jurisdiction and the CFTC's previous decisions with respect to such foreign board of trade.

2. Linked Contracts

A foreign board of trade may not provide direct access to US persons with respect to an agreement that settles against the price of one or more contracts listed for trading on a contract market or SEF registered with the CFTC unless such foreign board of trade daily publishes trade data, adopts position limits, has the ability to prevent or reduce the threat of price manipulation, provides the CFTC information regarding large positions and aggregate trader positions and agrees to promptly notify the CFTC of certain events. Foreign boards of trade that were previously exempted by the CFTC will continue to be exempted for 180 days after the enactment of this Act, but will be required to comply afterwards.

Preventing Manipulation – Position Limits, Large Trader Reporting

Position Limits

1. Swaps

The Act requires the CFTC to impose aggregate position limits on contracts traded on exchanges, SEFs, foreign boards of trade as well as swaps that are not traded on an exchange or SEF but which perform a significant discovery function, provided that bona fide hedges in physical commodities are excluded. In determining whether or not a swap performs a "significant discovery function", the CFTC will consider price linkage, arbitrage, material price reference and material liquidity. The Act also provides the CFTC with the ability to exempt, conditionally or unconditionally, any market participant or any type or class of swap from position limit requirements. The provisions regarding position limits with respect to commodities will be effective as of the date of the enactment of the Act, other than in respect of excluded commodities and agricultural commodities.

2. Security-based swaps

The Act requires the SEC to impose limits on the size of positions in any security-based swap held by any person. The SEC may require a person to aggregate their position in (a) any security-based swap and any security, loan or group of securities on which such security-based swap is based, or (b) any security-based swap and any security (or securities) a term of which is the basis for a material term of such security-based swap. The SEC may exempt, conditionally or unconditionally, any person, swap or transaction from position limit requirements. The SEC may also require self regulating organizations to set aggregate position limits with respect to their members.

Large Trader Reporting

Any position in a swap that had a significant price discovery function and which exceeds a size specified by the SEC or the CFTC, as applicable, may not be entered into unless reported to the applicable commission. Any person entering into such a swap is required to keep records of it.

Comment: These Restrictions May be Difficult to Implement: Establishing the amount of the position limit or the size of a large trade could be difficult, and it is not clear whether position limits are linked to the notional amount of a swap position or to an underlying asset.

Manipulation and False Information

The Act prohibits persons from using manipulative or deceptive practices in connection with swaps. In addition, the Act makes clear that false reporting of market information or conditions that affect the price of commodities are expressly prohibited.

Comment: False Reporting Unclear: It is not entirely clear what "false reporting of market information" encompasses. For instance, a bespoke transaction between two parties that involves a swap which does not trade at its true market value may be caught by the broad definition of "false reporting", as it could be deemed to provide a false view of the market at the time.

Restricting Retail Markets

A. Prohibition on Retail OTC Swaps

The Act prohibits any person that is not an eligible contract participant (discussed below) from entering into a swap unless such swap trades on an exchange (but not an SEF). Notwithstanding the exemptions provided in sections 3 and 4 of the Securities Act, the Act also prohibits the offer or sale of a security-based swap that is not registered with the SEC to a person who is not an eligible contract participant. Eligible contract participant currently includes an entity or an individual with over $10 million in assets and an individual with over $5 million in assets who enters into a swap for the purposes of risk management, and the Act provides regulatory authority to the CFTC and SEC to further define eligible contract participant.

Prohibition on Retail OTC Commodity Transactions

The Act generally prohibits a transaction in any commodity which is not traded on an exchange if the transaction is with a person who is not an eligible contract participant or eligible commercial entity and if the contract is leveraged or margined, or financed by one of the parties. (An eligible commercial entity is, broadly, an eligible contract participant with a commercial use for the relevant swap.) The Act excludes the following contracts from this prohibition:

- securities,
- swaps,
- foreign currency transactions,
- sales for physical delivery that occur within 28 days (or such other period as the CFTC may determine) or that are made in connection with the line of business of buyer and seller,
- identified banking products,
- contracts that are listed on national securities exchanges, and
- limited categories of other contracts.

Agricultural producers, packers, and handlers are deemed to be eligible commercial entities.

Comment: The prohibition on retail OTC commodity contracts, if leveraged, margined or financed, is potentially very broad. "Commodity" is very broadly defined under the current laws, so this prohibition on retail non-exchange traded commodity transactions (that are margined, leveraged or financed) could potentially affect a very wide range of transactions. The exclusion for agricultural businesses raises the question as to why other small businesses are not excluded.

Securities Laws

Application of Securities Laws to Security-Based Swaps

The Act generally amends the Securities Exchange Act and the Securities Act to include securities-based swaps in the definition of security and to expand the anti-fraud provisions for securities-based swaps.

Beneficial Ownership/Corporate Insider Rules

The Act expands Section 13 of the Exchange Act (which requires reporting of ownership of listed shares in excess of certain levels) and Section 16 (which sets requirements for transactions by corporate insiders) so that security-based swaps are covered by these sections if the SEC, after consultation with prudential regulators and the Treasury, ruled that the purchase of a security-based swap (or a type of security-based swap) confers beneficial ownership of the underlying security on the purchaser.

Miscellaneous

Exemptions

The Act exempts swaps and security-based swaps from state gaming and bucket-shop laws as well as insurance laws. The Act also exempts security-based swaps from state securities laws (other than general anti-fraud laws).

Comment: Exemption from Insurance Laws: This exemption will prevent the regulation of credit default swaps as insurance by state insurance regulators.

Non-preemption of the Federal Energy Regulatory Commission

The Act does not restrict the FERC's regulatory authority or the authority of state regulatory agencies to set rates and tariffs, and the CFTC may exempt a swap that is entered into under a tariff or rate schedule approved by a state regulatory agency.

International Harmonization

The Act provides that in order to promote consistent global swap regulation, the SEC, the CFTC and the Treasury will consult and coordinate with foreign regulators and enter into information sharing agreements with foreign regulators as may be necessary to protect investors and swap counterparties.

General Rule-Making Timeframe

The SEC and the CFTC will be required to promulgate the rules and regulation required of each of them under the Act not later than 360 days after the date of enactment of the Act, unless expressly stated otherwise.

Title VIII. Payment, Clearing, and Settlement Supervision

Payment, Clearing, and Settlement Supervision

Title VIII reforms the transaction clearance and settlement process to mitigate systemic risk in the financial system and to promote financial stability. The Act seeks to accomplish this by: (i) designating certain entities and activities as systemically important; (ii) facilitating the creation of risk management standards; and (iii) providing regulators with increased examination, enforcement and information gathering authority. Designated entities are also granted access to the Fed's discount window.

Identification of Systemically Important Activities

Section 804 authorizes the Financial Stability Oversight Council ("Oversight Council") to designate whether a financial market utility or payment, clearing or settlement activity is, or is likely to become, systemically important.

- A "financial market utility" is any entity that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person. Securities and futures exchanges solely providing facilities to compare data respecting the terms of settlement of securities or futures transactions effected on such exchange are excluded from this definition. Similarly, certain market intermediaries (e.g., broker-dealers, investment advisers, and futures commission merchants) acting on behalf of financial market utilities are also excluded.
- "Payment, clearing or settlement activity" includes any activity carried out by one or more financial institutions to facilitate the completion of financial transactions. Financial transactions include funds transfers, securities contracts, forward contracts, repurchase agreements, swaps, and financial derivatives contracts. They do not include, for example, any offers or sales of securities under the 1933 Act, or any quotation, order entry, negotiation, or other pre-trade activity.
- "Systemic importance" means any situation where the failure of or a disruption to the functioning of a financial market utility or the conduct of a payment, clearing or settlement activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system.

A financial market utility or payment, clearing or settlement activity may only be "designated" (or have such status rescinded) by a two-thirds vote of the Oversight Council (including the vote of its chairperson). When identifying designated activities, the Oversight Council must consider, among other things, the aggregate monetary value of transactions processed, exposure of the financial market utility or a financial institution to its counterparties, and the effect a failure or disruption has on critical markets, financial institutions or the broader financial system. Generally, the Oversight Council must also consult with relevant supervisory agencies and the Board of Governors, publish notice of the designation in the federal register, and afford industry participants an opportunity to challenge such designation through a written submission or oral argument.

Establishment of Risk Management Standards

Section 805 authorizes the Board of Governors to prescribe risk management standards governing (i) payment, clearing and settlement activities of designated financial market utilities, and (ii) the conduct of designated activities by financial institutions (e.g., risk management policies and procedures, margin and collateral requirements, etc.). Such standards must be designed to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. The CFTC and SEC are each authorized to prescribe regulations, in consultation with the Board of Governors, containing risk management standards.

Special Rules for Designated Financial Market Utilities

Under Section 806, the Board of Governors provides designated financial market utilities ("DFMU") with access to the Federal Reserve Bank discount window. It requires a DFMU, based on standards established by the Board of Governors, to give advance notice to its supervisory agency and the Board of Governors of any proposed change to its rules, procedures or operations that could materially affect the nature or level of risks presented by the DFMU. Absent an emergency situation, if the Board of Governors or the supervisory agency objects to the change within 60 days, the DFMU may not make the change. Section 813 also requires the SEC, CFTC and Board of Governors to work together and develop common risk management supervision programs for certain clearing entities.

"Section 806 allows designated financial market utilities to access the Federal Reserve Bank discount window"

Examination and Enforcement Authority

Section 807 sets out the examination and enforcement authority over DFMUs. It first requires the applicable supervisory agency for a DFMU (e.g., the SEC for a broker-dealer) to conduct annual examinations of the DFMU, and allows the examination of outside service providers supplying services integral to the operation of the DFMU. Such agencies must consult with the Board of Governors, which may, at its discretion participate in examinations of DFMUs. The Board of Governors may also recommend that a supervisory agency take enforcement action against a DFMU. Finally, the Board of Governors, after consulting with the Oversight Council and the supervisory agencies, may take emergency enforcement action against a DFMU itself if: (i) it determines that there is an imminent risk of substantial harm to financial institutions, critical markets, or the broader financial system; and (ii) the imminent risk of harm precludes the Board of Governors from recommending enforcement action to a supervisory agency.

Similarly, section 808 establishes examination and enforcement authority over financial institutions that engage in designated activities. Specifically, it would authorize financial regulators to examine and take enforcement action against each financial institution subject to the Board of Governors' risk management standards with respect to a designated activity. The Board of Governors also has backup examination and enforcement authority over such institutions.

Information Gathering Authority

Section 809 generally authorizes the Oversight Council to require any financial market utility or financial institution engaged in payment, clearing or settlement activities to submit information to the Oversight Council for the purpose of making the required systemic importance determination. The Board of Governors and Oversight Council must coordinate with the appropriate financial regulator before directly requesting material information from, or imposing reporting or recordkeeping requirements on, any financial market utility or financial institution.

Section 809 does not only allow the sharing of information collected among the Oversight Council, Board of Governors, and relevant financial services regulators and authorities; but also with state financial institution supervisory agencies, and foreign regulators and authorities, subject to reasonable assurances of confidentiality and lawful use.

Title IX. Investor Protections and Improvements to the Regulation of Securities

Title IX directs toward improving and strengthening investor protection and the authority and operations of the SEC. It directs the SEC to study and consider rules subjecting broker-dealers to a fiduciary standard of care similar to the standard applicable to investment advisers. It also includes provisions: (i) establishing additional whistleblower protections; (ii) increasing the SEC's authority to seek collateral bars on violators of the Exchange Act and Advisers Act; (iii) requiring the SEC to submit annual reports to Congress on its activities; and (iv) strengthening aspects of corporate governance. Subtitle H of Title IX significantly impacts regulation of the municipal securities industry by, for example: (i) requiring municipal advisors (e.g., persons who advise municipal entities) to register with the SEC; (ii) expanding the authority of the MSRB over municipal advisors; and (iii) creating an Office of Municipal Securities within the SEC to administer SEC rules regarding municipal securities and coordinate rulemaking and enforcement actions with the MSRB.

A – Increasing Investor Protection

Establishment of the Investor Advisory Committee

Section 911 establishes the Investor Advisory Committee to advise and consult with the SEC on, among other things, regulatory priorities, fee structures, effectiveness of disclosures, and investor protection. Section 915 establishes a new Office of the Investor Advocate ("OIA") within the SEC, and section 919D requires the appointment of an OIA Ombudsman. The purpose of this office is, in general, to assist investors in resolving problems with the SEC and self-regulatory organizations.

Amendments to the Exchange Act

Subtitle A amends the Exchange Act to: (i) streamline the SEC's approval or disapproval of rule changes proposed by self-regulatory organizations and exchanges (section 916); (ii) authorize the SEC to engage in investor testing for the purpose of evaluating any of its rules or programs (section 912); and (iii) authorize the SEC to issue rules designating documents or information broker-dealers must provide to retail investors before such investors purchase an investment product or service (section 919).

Study and Rulemaking Regarding the Obligations of Brokers, Dealers and Investment Advisers to Retail Investors

Section 913 requires the SEC to conduct a study evaluating the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers and their respective associated persons when providing personalized investment advice concerning securities to retail investors. This study must identify any legal or regulatory gaps or overlap in such standards that can be addressed by rule or statute. Specifically, the SEC is required to consider, among other things, the potential impacts of:

- Requiring broker-dealers to meet the fiduciary standard currently imposed on investment advisers for providing personalized investment advice about securities to retail customers;
- Eliminating the broker-dealer exclusion from the definition of investment adviser under the Advisers Act; and
- Authorizing the SEC to create a self-regulatory organization for investment advisers.

The SEC must report the study results to Congress within one year of the Act's enactment. This report must (i) describe the SEC's findings, conclusions and recommendations including a description of its considerations, analysis and the

"The SEC is required to conduct a study evaluating the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers and their respective associated persons, when providing personalized investment advice concerning securities to retail investors."

public input considered; (ii) an analysis of any legal or regulatory gaps or overlap in the protection of retail customers; and (iii) whether the SEC requires additional statutory authority to address such gaps or overlap. If the SEC identifies any regulatory gaps or overlap as described above, it must commence a rulemaking within two years of the Act's enactment.

Additional Studies

Subtitle A requires the completion of additional studies associated with securities regulation, including studies by the: (i) SEC identifying and proposing methods to improve financial literacy among retail investors (section 917); (ii) GAO on mutual fund advertising (section 918); (iii) GAO on the potential conflicts of interest between the staffs of the investment banking and equity and fixed income securities analyst functions within the same securities firm (section 919A); (iv) SEC on improving investor access to registration information on investment advisers and broker-dealers (section 919B); (v) GAO to evaluate the effectiveness of State and Federal regulations governing financial planners and identify any gaps (section 919C); and (vi) SEC on enhancing investment adviser examinations (section 914).

B – Increasing Regulatory Enforcement and Remedies

SEC Authority to Issue Rules Related to Mandatory Pre-Dispute Arbitration

Section 921 amends the Exchange Act and the Advisers Act to authorize the SEC to consider prohibiting or limiting the use of mandatory pre-dispute arbitration agreements by broker-dealers and investment advisers.

Whistleblower Protection

Section 922 amends the Exchange Act as follows:

- Authorize the SEC to pay awards to whistleblowers who voluntarily provide original information to the Commission that led to the successful enforcement action resulting in monetary sanctions in excess of $1 million. The award is paid in an aggregate amount of not less than 10% but not more than 30% of the amount of the sanctions. The SEC considers the following criteria in determining the amount of the award: (i) the significance of the information provided by the whistleblower to the success of the enforcement action; (ii) the degree of assistance provided by the whistleblower; (iii) the programmatic interest of the SEC in deterring violations by making awards to whistleblowers; and (iv) such relevant factors as the SEC may establish by the rule or regulation.
- No award is provided to certain government employees, whistleblowers who are convicted of a criminal violation related to the enforcement action for which he or she would otherwise receive an award, or whistleblowers who gain the information through an audit or who fail to submit information to the SEC in the form the agency requires. Similarly, a whistleblower is not entitled to an award if he knowingly provides false information to the SEC.
- Any determination by the SEC under this section, including whether, to whom, or in what amount to make awards are at the discretion of the SEC. Except for determinations on the amount of the award, any other determination may be appealed to the appropriate US Court of Appeals within 30 days after the SEC issues its decision.
- Establish an Investor Protection Fund for paying awards to whistleblowers and to fund the activities of the SEC's Inspector General through certain monetary sanctions.
- Require the SEC to report to Congress annually on the whistleblower award program.
- Prohibit employers from retaliating against whistleblowers and provide an express private right of action against employers who do so. The action must be brought within 6 years after the date on which the violation occurred, or no more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee, and in no event more than 10 years after the date on which the violation occurs. An individual prevailing in such an action will obtain relief including reinstatement, 2 times the back pay otherwise owed with interest, and compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.
- Information provided by a whistleblower that could reasonably be expected to reveal the identity of the whistleblower is generally required to be kept confidential and privileged as an evidentiary matter, but may be used in a criminal investigation and shared with the Attorney General or certain other foreign, federal or state agencies at the SEC's discretion.
- Establish a separate office within the SEC to administer and enforce the new whistleblower provisions of the Act.

Sections 923 and 924 make certain conforming amendments for whistleblower protection to the federal securities laws and set forth implementation and transition provisions for whistleblower protection, respectively.

Collateral Bars

Section 925 permits the SEC to impose collateral bars under the Exchange Act and the Advisers Act prohibiting violators from associating with a broad range of SEC regulated entities. This is a departure from the current standard that limits collateral bars solely from entities regulated under the particular statutory provisions under which the violation occurred.

Disqualification of Felons and other "Bad Actors" from Regulation D Offerings

Section 926 requires the SEC to issue rules disqualifying an offering or sale of securities as a Regulation D offering where the person offering the securities: (i) is subjected to a final order of a State securities commission or certain other state agencies that (1) bars the person from association with regulated entities or

"The SEC's enforcement authority is expanded to include those who aid and abet primary violators of the Securities Act and 1940 Act, and recklessness satisfies the intent standard for such claims."

from engaging in the business of securities, insurance and banking or in savings association or credit union activities, or (2) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent or manipulative conduct within the 10 year period ending on the date of the filing or sale; or (ii) has been convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC.

Clarification Regarding Section 205 of the Advisers Act

Section 928 amends the Advisers Act to clarify that Section 205 of the Act, which deals with investment advisory contracts, does not apply to state-registered investment advisers.

Fair Funds Amendments

Section 929B permits the SEC to add civil penalty payments to a fund established for the benefit of the victims of a securities law violation regardless of whether the SEC also obtains disgorgement against the violator, as is required by current law.

Nationwide Service of Subpoenas

Section 929E amends the Securities Act, the Exchange Act, the Advisors Act, and the Investment Company Act to make nationwide service of subpoenas available to the SEC in civil actions it files in federal district courts.

Formerly Associated Persons

Section 929F amends the Exchange Act to make it clear that the SEC may bring suits against persons formerly associated with a registered entity to prevent individuals from avoiding a penalty or bar simply because they are no longer associated with the registered entity.

SIPC Reforms

Section 929H makes various amendments to the Securities Investor Protection Act, including increasing the cash limit of protection and defining the standard maximum cash advance amount.

Protecting Confidentiality of Materials Submitted to the SEC

Section 929I amends the Exchange Act to provide that, except in certain circumstances, the SEC cannot be compelled to disclose records or information obtained from registered persons for use by the SEC in furtherance of its regulatory and oversight purposes, and is also exempt from Freedom of Information Act requests under 5 U.S.C. § 552. Similar amendments to the Investment Company Act and Advisers Act apply for records or information provided to the SEC under those statutes.

Expansion of Audit Information to be Produced and Exchanged

Section 929J provides that a foreign public accounting firm must, if requested, produce its audit work papers to the SEC and PCAOB if it "performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, issues an audit report, performs audit work, or conducts interim reviews." It also provides that any registered public accounting firm in that instance must produce the foreign firm's audit work papers, if asked, and secure the agreement of the foreign firm that it will cooperate as a condition of such reliance.

Sharing Privileged Information with Other Authorities

Section 929K amends the Exchange Act to allow the SEC and domestic and foreign securities authorities and law enforcement authorities to share information without waiving any privilege applicable to that information. It also prevents the SEC from being compelled to disclose privileged information obtained from a foreign securities authority or law enforcement authority, if the foreign authority represented to the SEC in good faith that the information is privileged.

Enhanced Application of Antifraud Provisions

Section 929L expands the Exchange Act market manipulation and short sales authority by:

- Extending Section 9 (market manipulation) and 10(a)(1) (short sales) to cover any security "other than a government security," rather than just securities "registered on a national securities exchange."
- Extending Section 9(b) (options) to non-exchange transactions in options.
- Amending Section 9(c) to extend Section 9 to all brokers and dealers, not just "member[s] of a national securities exchange."
- Amending Section 15(c)(1)(A) to cover exchange transactions, not just over-the-counter transactions.

Aiding and Abetting Authority

The Exchange Act and the Advisers Act currently permit the SEC to bring actions for aiding and abetting violations of those statutes. Section 929M extends the SEC's enforcement

> "Recordkeeping and examination requirements for custodians who hold property of clients of investment companies and investment advisers are expanded."

authority to file actions against persons who aid and abet primary violators of the Securities Act and the Investment Company Act. Section 929O also makes clear that recklessness satisfies the intent standard for aiding and abetting liability in SEC enforcement actions under the Exchange Act. In addition, Section 929N would amend the Advisers Act to authorize the SEC to impose penalties for aiding and abetting violations of that Act.

Additional Provisions

Subtitle B also:

- Authorizes the SEC to impose civil penalties in cease and desist proceedings.
- Extends the SEC's antifraud jurisdiction to cover significant steps in furtherance of a violation outside the US and cover foreign conduct with foreseeable substantial effects within the US
- Applies control person liability in SEC enforcement proceedings.
- Expands recordkeeping and examination requirements for custodians who hold property of clients of investment companies or investment advisers.
- Gives the SEC authority to adopt rules requiring more timely reporting by persons acquiring more than 5% ownership interest in an issuer.
- Extends fingerprinting requirements to personnel of national securities exchanges and national securities associations.
- Invalidates any contractual provisions requiring persons to waive compliance with SRO rules.
- Requires the SEC to complete investigations and examinations within certain time frames.
- Allows SIPC assessments and penalties for fraud under the Securities Investors Protection Act ("SIPA"), and establishes increased civil and criminal penalties for persons who misrepresent SIPC membership or SIPA coverage.
- Prohibits manipulative short sales and requires that customers be notified that they may elect not to allow their securities to be used in connection with short sales and that the broker may receive compensation if the shares are so used.
- Requires the SEC to solicit public comment and conduct a study to determine the extent to which private rights of action under the antifraud provisions of the securities laws should be extended to cover: (1) conduct within the US that constitutes a significant step in furtherance of the violation, even if it occurs outside the US and involves only foreign investors; and (2) conduct occurring outside the US that has "a foreseeable substantial effect" within the US.
- Requires the GAO to conduct a study on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws.

C – Improvements to the Regulation of Credit Rating Agencies

Subtitle C of Title IX of the Act significantly alters the regulation of credit rating agencies. Congressional findings assert that the credit rating agencies contributed to the financial crisis of 2008 by assigning ratings to asset-backed securities that proved to be inaccurate, leading to mismanagement of risks by investors in reliance on such "inaccurate" ratings. Based on these findings, reform of the US credit rating system has become a focal point of Congressional financial reform efforts. Unless otherwise specified, the SEC is required by the Act to issue final regulations not later than one year after the date of enactment of the Act.

In the course of its deliberations, Congress has debated over a controversial provision that significantly changes the system for assigning initial credit ratings. Rather than establishing such a mechanism, however, the Act requires the SEC to conduct a study on its effectiveness. Please refer to the summary under "Studies" for a description of this study.

New management requirements

To manage conflicts of interest, Section 932 of the Act requires each nationally recognized statistical rating organization ("NRSRO") to establish an internal control system, in addition to the creation of certain management positions.

Internal control structure

Each NRSRO is required to establish, maintain, enforce, and document an internal control structure governing the implementation of and adherence to policies, procedures and methodologies for determining credit ratings. Annually, each NRSRO is required to submit to the Commission an internal controls report attesting to such actions taken.

Qualification standards for credit rating analysts

Not later than one year after the date of enactment of this Act, Section 936 requires that the SEC issue rules that are reasonably designed to ensure that any person employed by an NRSRO to perform credit ratings meets standards of training, experience and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates. Such credit rating analysts will be tested for knowledge of the credit rating.

Treatment of NRSRO subsidiaries

If an NRSRO is a subsidiary of a parent entity, the board of directors of the parent entity will satisfy the requirement by designating a committee of such board of directors, where at least half of the members of the committee are independent, and at least one member of the committee is a user of ratings from an NRSRO.

Corporate governance

Section 932 requires at least half, but no fewer than two, of the members of the board to be "independent", with no financial stake in credit ratings. Independent directors are not permitted, other than in his or her capacity as a member of the board, to accept any consulting, advisory, or other compensatory fee from the NRSRO or be associated with an NRSRO and will be disqualified from any deliberation involving a specific rating in which the independent board member has a financial interest in the outcome of the rating. The Act requires that "a portion" of the independent directors includes users of ratings from an NRSRO.

The compensation of the independent directors is not permitted to be linked to the business performance of the NRSRO and the term of office is not permitted to exceed five years.

The board of directors, in addition to its overall responsibilities, is required to oversee the establishment, maintenance and enforcement of policies and procedures for determining credit ratings and managing conflicts of interest, as well as for developing an internal control system.

Compliance officer

Each NRSRO is required to designate an individual to serve as a compliance officer. The compliance officer is responsible for addressing complaints regarding the credit ratings issued and compliance with securities laws and internal policies and procedures required under the Act. The compliance officer is required to submit an annual report attesting to such NRSRO's compliance with the securities laws and internal policies and procedures. The compliance officer, while serving in such capacity, is not permitted to perform any function that may interfere with his or her duties, including performing credit ratings, participating in the development of ratings methodologies or models, performing marketing or sales functions, or participating in establishing compensation.

Regulation of conflicts of interest

Under the Act, the SEC uses its authority to prohibit, or require the disclosure of, any conflicts of interest relating to the issuance of credit ratings by an NRSRO, including without limitation, conflicts of interest relating to the provision of consulting, advisory, or other services by an NRSRO to the obligor, or any affiliate

Look-back requirement

Each NRSRO is required to establish, maintain and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the NRSRO or the issuer, underwriter, or sponsor of a security or money market instrument subject to a

Credit rating assignment requirements

The procedures and methodologies, including qualitative and quantitative data and models, used by NRSROs in the issuance of credit ratings are required to be:

- approved by the board of the NRSRO, or equivalent organizational body or officer; and
- in accordance with the internal policies and procedures of the NRSRO for the development and modification of credit rating procedures and methodologies.

When material changes to credit rating procedures and methodologies are made, the NRSRO is required to:

- consistently apply the changes to all credit ratings to which the changed procedures and methodologies apply;
- to the extent the changes are made to rating surveillance procedures and methodologies, apply the changes to then-current credit ratings by the NRSRO within a reasonable time period; and
- publicly disclose the reason for the change.

Independent information

In producing a credit rating, Section 935 requires that an NRSRO considers information about an issuer that the NRSRO has, or receives from a source other than the issuer or underwriter, that the NRSRO finds credible and potentially significant to a rating decision.

Universal ratings symbols

Under Section 938, each NRSRO is required to establish, maintain, and enforce written policies and procedures that assess the possibility that an issuer of a security or money market instrument will default or fail to make timely payments, clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating, and apply any symbol consistently for all types of securities and money market instruments for which the symbol is used.

credit rating of the NRSRO also participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the one-year period preceding the date an action was taken with respect to the credit rating, the NRSRO is required to conduct a review to determine whether any conflicts of interest of the employee influenced the credit rating and take action to revise the rating if appropriate. Such policies and procedures are subject to review by the SEC not less frequently than annually and whenever such policies are materially modified or amended.

Each NRSRO is required to submit to the SEC a report in any case such NRSRO knows or can reasonably be expected to know where a person associated with such NRSRO within the previous five years obtains employment with any obligor, issuer, underwriter, or sponsor of a security or money market instrument for which the organization issued a credit rating during the 12-month period prior to such employment, if such employee was a senior officer of such NRSRO, or participated or supervised an individual who participated in any capacity in determining credit ratings for such obligor, issuer, underwriter, or sponsor. Such report is made public by the SEC.

New disclosure requirements

In an effort to increase transparency, Section 932 of the Act would subject NRSROs to increased disclosure requirements.

Elements of required disclosure

Such disclosure is required to include:

- the credit ratings produced;
- the main assumptions and principles used in constructing the procedures and methodologies;
- the potential limitations of the credit ratings;
- information on the uncertainty of the credit rating;
- whether and to what extent third party due diligence services have been used, including findings or conclusions of such third party, and written certification by the third party;
- a description of the data relied upon for determining the credit rating;
- a statement regarding an overall assessment of the quality of information available and considered in producing a rating;
- information relating to conflicts of interest;
- an explanation of the potential volatility of the credit rating;
- information relating to the historical performance of the rating and the expected probability of default and expected loss; and
- information on the sensitivity of the rating to assumptions made by the NRSRO.

Initial credit ratings

Each NRSRO is required to publicly disclose information on the initial credit ratings determined by such NRSRO for each type of obligor, security, and money market instrument, and any subsequent changes to such credit ratings. Such disclosures are required to include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the NRSRO, and are required to be made freely available by the NRSRO on an easily accessible portion of its website, and in writing, when requested.

To allow users of credit ratings to compare the performance of credit ratings across NRSROs, such disclosures are required to be made comparable among NRSROs.

Form for disclosures

Each NRSRO is required to prescribe a form, accompanying the publication of each credit rating, that discloses information relating to the assumptions underlying the credit rating procedures and methodologies, the data relied on to determine the credit rating, and, if applicable, how the NRSRO used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating. Such disclosure is required to be made readily available to users of credit ratings. The content of these disclosures is required to be provided in a manner that is directly comparable across types of securities.

Notification for users of credit ratings

Each NRSRO is required to notify users of credit ratings of the version of a procedure or methodology, including qualitative and quantitative inputs, used with respect to a particular credit rating, when a material change is made to such procedure or methodology, when a significant error is identified in a procedure or methodology that may result in credit rating actions, and of the likelihood of a material change to a procedure or methodology used that may result in a change in current credit ratings.

Referring tips to law enforcement or regulatory authorities

Each NRSRO is required to refer to the appropriate law enforcement or regulatory authorities any information that the NRSRO receives from a third party and finds credible that alleges that an issuer of securities rated by the NRSRO has committed or is committing a material violation of law that has not been adjudicated by a Federal or State court.

Elimination of exemption from Fair Disclosure Rule

Under Section 939B, not later than 90 days after the date of enactment of this Act, the SEC is required to remove from Regulation FD (17 C.F.R. 243.100) the exemption for entities whose primary business is the issuance of credit ratings.

New penalties for violations

Under Section 932 of the Act, any NRSRO in violation of any rules promulgated under the Act may have its registration revoked by the SEC.

Any person who is associated with, who is seeking to become associated with, or, at the time of the alleged misconduct, who was associated or was seeking to become associated with an NRSRO may be censured, suspended, barred from being associated with such NRSRO, or have his or her activities or functions limited by the Commission. Additionally, a person responsible for supervising another individual, in failing to reasonably prevent a violation of the securities laws by such individual, may face penalties for such omission.

The Office of Credit Ratings

In order to administer the new rules under the Act, Section 932 requires that the SEC establish a new administrative office within the SEC, the Office of Credit Ratings.

Rule-making authority

The Office of Credit Ratings will have the authority to establish rules, fines, and other penalties applicable to any NRSRO that violates the requirements relating to credit rating regulation under the Act. Such rules, fines and penalties will be established in order to promote accuracy in credit ratings issued by NRSROs and to ensure that such ratings are not unduly influenced by conflicts of interest.

Annual exams and reports

The Office of Credit Ratings will be required to conduct an annual examination of each NRSRO, reviewing such subjects as compliance, management of conflicts of interest, implementation of ethics policies, governance, processing of complaints, and post-employment activities of former staff of such NRSRO. Findings acquired from such examination will be made available to the public in an annual report, including the responses by such NRSRO to any material regulatory deficiencies identified by the SEC, and whether such NRSRO has appropriately addressed the recommendations of the SEC.

“The overriding public policy concern evidenced in the Act is to align incentives among originators, securitizers and investors.”

Private actions

Under Section 933 of the Act, a private action for money damages brought against a credit rating agency is deemed sufficient where the complaint states with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluating credit risk or to obtain reasonable verification of such factual elements from other sources that the credit rating agency considered to be competent and that were independent of the issuer and underwriter.

Studies

Under Section 939 of the Act, the SEC and the GAO are required to conduct several studies examining different aspects of credit rating agencies.

The SEC is required to undertake a study on the feasibility and desirability of standardizing credit ratings terminology, standardizing the market stress conditions under which ratings are evaluated, requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations, and standardizing credit rating terminology across asset classes.

The SEC is required to conduct a study of the independence of NRSROs and how that independence affects the ratings issued by the NRSROs. Such study will evaluate the management of conflicts of interest raised by an NRSRO providing other services and the potential impact of rules prohibiting an NRSRO that provides a rating to an issuer from providing other services to the issuer.

Review of reliance on ratings

Each federal agency is required to review any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument and any references to or requirements in such regulations regarding credit ratings.

Each such agency would be required to modify any such regulations identified by the review to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations.

The SEC undertakes a study examining alternative methods for addressing the conflict of interest problems inherent in an issuer-pays credit rating agency system. Following the study, the SEC has the rule-making authority to establish a system for the assignment of NRSROs to determine the initial credit ratings of structured finance products in a manner that prevents the issuer, sponsor, or underwriter of the structured finance product from selecting the NRSRO that will determine the initial credit ratings and monitor such credit ratings.

The GAO is required to conduct a study on alternative means for compensating NRSROs in order to create incentives for NRSROs to provide more accurate credit ratings.

The GAO is also required to conduct a study of the feasibility and merits of creating an independent professional organization for rating analysts employed by NRSROs.

Statutory references

Under Section 939 of the Act, statutory references to “investment grade” in the FDIA have been replaced with “standards of credit-worthiness as established by the Corporation.” In the Investment Company Act of 1940, references to “investment grade” have been replaced with “standards of credit-worthiness as the Commission shall adopt.” In Section 5136A of title LXII of the Revised Statutes of the United States (12 U.S.C. 24a), references to “any applicable rating” have been replaced with “standards of credit-worthiness established by the Comptroller of the Currency.” In the Securities Exchange Act of 1934, references to “is rated in one of the…highest rating categories by at least one [NRSRO]” are replaced with “meets standards of credit-worthiness as established by the Commission.”

Effect of Rule 436(G)

Under Section 939G of the Act, Rule 436(G), promulgated by the SEC under the Securities Act of 1933, has no force or effect. Rule 436(G) exempts credit ratings issued by NRSROs from being considered a part of the registration statement prepared and certified by a person under Sections 7 and 11 of the Act.

D – Improvements to the Asset-Backed Securitization Process

Subtitle D of Title IX of the Act amends the Securities Exchange Act and the Securities Act with respect to the treatment of asset-backed securities, specifically focusing on credit risk retention, disclosure in respect of asset-backed securities and due diligence analysis. The overriding public policy concern evidenced in the Act is to align incentives among originators, securitizers and investors so as to address the credit quality of assets underlying asset-backed securities and disclosure in respect of such assets and the transactions and parties relating thereto.

The Act does not use the definition of asset-backed security in SEC Regulation AB (17 C.F.R. §229.1101(c)) ("Reg AB"), but rather introduces a new definition for its purposes as a new Securities Exchange Act Section 3(a)(77): a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, and any other security that the SEC, by rule, determines to be an asset-backed security for purposes of this definition, but excluding any "security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company." The examples included in the Act definition of asset-backed security are: (1) collateralized mortgage obligations; (2) collateralized debt obligations ("CDOs"); (3) collateralized bond obligations; (4) CDOs of asset-backed securities; and (5) CDOs of CDOs. Notably, unlike the asset-backed security definition in Reg AB, the Act does not impose additional conditions, such as issuer activity restrictions and underlying asset performance characteristics, resulting in a broader pool of securities potentially qualifying as "asset-backed securities" for purposes of the Act and the regulations promulgated thereunder.

Having defined the scope of securities which are impacted by the terms of Subtitle D, the Act proposed by the Conference Committee for purposes of reconciling the bills passed by the Senate and the House, sets out the amendments to the Securities Exchange Act and the Securities Act for purposes of the topics mentioned above.

Credit Risk Retention

The principal provisions which form the basis for credit risk retention requirements are set out in Section 941 of the Act. In particular, a new Section 15G to the Securities Exchange Act is created thereby. Section 15G directs (1) federal banking agencies and the SEC to jointly prescribe regulations that require "any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells or conveys to a third party", and (2) the Federal banking agencies, the SEC, the Secretary of Housing and Urban Development and the Federal Housing Finance Agency to jointly prescribe regulations to require "any securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party", ***which regulations in both instances must be prescribed within 270 days of the enactment of such new Section 15G.*** The Act defines "securitizer" as "(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer."

"Assets, in this context, include loans."

As further described below, the Act requires that the implementing regulations adopted by the Federal banking agencies and the SEC meet certain minimum standards, subject to a general exemptive authority given to the rulemaking bodies. These standards are:

- prohibiting a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that it is required to retain with respect to an asset;
- requiring that a securitizer retain at least 5 percent of the credit risk for any asset transferred, sold or conveyed through an asset-backed security, unless it is a "qualified residential mortgage" asset or is collateralized solely by "qualified residential mortgages". This five percent risk retention requirement will be subject to certain additional exceptions further discussed below;
- requiring that a securitizer retain less than 5 percent of the credit risk if an asset is not a "qualified residential mortgage", but the originator meets the minimum underwriting standards of Section 15G;
- specifying the (i) permissible forms of risk retention for purposes of Section 15G, (ii) the minimum duration of the risk retention required under Section 15G, and (iii) a carve out from the risk retention requirement if all the assets collateralized are "qualified residential mortgages;"
- requiring that the risk retention requirements apply to any insured depository institution acting as a securitizer;

- in the case of commercial mortgages, specifying the permissible types, forms, and amounts of risk retention that meet the requirements of Section 15G; which, as determined by the federal banking agencies and the SEC, may include (1) specified amount or percentage of total credit risk retained, (2) permissibility of third party acquisition of first-loss position, (3) vetted underwriting standards and (4) adequate representations and warranties and related enforcement mechanisms;

- providing for certain exemptions, such as exempting securitizations of assets issued or guaranteed by the US, or an agency of the US (excluding Fannie Mae or Freddie Mac) or asset-backed securities issued or guaranteed by any State, political subdivision of a State or territory or any public instrumentality of a State or territory that is exempt from registration under Section 3(a)(2) of the Securities Act;

- establishing appropriate standards for retention of an economic interest with respect to CDOs, securities collateralized by CDOs and similar instruments collateralized by other asset-backed securities;

- permitting allocations of risk-retention requirements between securitizers and originators of assets sold to securitizers; and

- establishing asset classes with separate rules for securitizers of different classes of assets, and underwriting standards established by the federal banking agencies for such classes that specify the terms, conditions and characteristics of a loan within the asset class that indicate low credit risk.

In implementing the standards by which risk retention would be allocated between securitizers and originators, the federal banking agencies and SEC are required to reduce the risk retention percentage applicable to securitizers by the percentage of risk retention required of originators and to consider (1) whether the assets sold to securitizers have terms, conditions and characteristics that reflect low credit risk, (2) whether secondary market activity creates incentives for imprudent origination of the relevant type of assets sold to the securitizer, and (3) the potential impact of risk retention obligations on access to credit on reasonable terms for consumers and businesses (which may not include the transfer of credit risk to a third party). The Act defines "originator" for purposes of Section 15G as "a person who (A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset backed security; and (B) sells an asset to a securitizer."

As previously mentioned, The Act grants the Federal banking agencies and the SEC broad power to adopt exemptions, exceptions or adjustments to the rules issued in relation to Section 15G, including in respect of the risk retention requirements for classes of institutions or assets and the prohibition on hedging retained credit risk by securitizers, subject to the requirement that such exemptions, exceptions or adjustments (1) help ensure high quality underwriting standards and encourage appropriate risk management practices by securitizers and originators, (2) improve access to credit on reasonable terms, or (3) otherwise be in the public interest and for the protection of investors. Any loan or other financial asset made, insured, guaranteed or purchased by any institution that is under the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation, and any residential, multi-family, or health care facility mortgage loan asset, or securitization of the same, insured or guaranteed by the US or an agency of the US (which will not include Fannie Mae, Freddie Mac or the Federal home loan banks), are also exempt from any risk retention provisions.

The Federal banking agencies, the SEC, the Department of Housing and Urban Development and the Federal Housing Finance Agency are required to jointly define the term "qualified residential mortgage" and issue regulations to exempt qualified residential mortgages from risk retention requirements. The definition is required to take into consideration certain underwriting and product features (examples of which are set out in Section 15G) that historical loan performance data indicate a lower default risk, and will exclude asset-backed securities collateralized by tranches of other asset-backed securities. Further, the SEC is directed to require an issuer, for each issuance of an asset-backed security collateralized solely by qualified residential mortgages, to certify that it has evaluated the effectiveness of its internal supervisory controls for ensuring all such assets are qualified residential mortgages.

The chairperson of the Financial Stability Oversight Council coordinates all joint rulemaking under Section 13G.

The regulations issued under Section 15G will be required to be effective one year after publication in the Federal Register for securitizers and originators of asset-backed securities backed by residential mortgages, and two years after such publication for securitizers and originators of all other classes of asset-backed securities.

Enforcement of these rules is by the appropriate federal banking agency (for any securitizer that is an insured depository institution) or by the SEC (for any securitizer that is not an insured depository institution). Section 15G does not address who is responsible for enforcement against originators.

Disclosure and Reporting for Asset-Backed Securities

Section 942 of the Act amends Section 15(d) of the Exchange Act and Section 7 of the Securities Act in order to add new asset-backed securities disclosure and reporting obligations. Section 15(d) is amended to remove the exemption from Exchange Act filing requirements for asset-backed securities held by fewer than 300 persons. Further, the amendment gives the SEC rulemaking authority to provide for different suspension or termination rules for asset-backed securities of any class, and authority to classify issuers and prescribe requirements for classes of issuers under Section 15(d) of the Exchange Act.

In addition, Section 7 of the Securities Act is amended to require the SEC to adopt regulations under such Section 7 requiring each issuer of asset-backed securities to disclose, for each tranche or class of security, information regarding the assets backing that security. The SEC is required to set standards for the format of the data provided to facilitate comparison of such data across securities in similar types of asset classes, and has to, at a minimum, require such issuers to disclose asset-level or loan-level data if necessary for investors to independently perform due diligence. Such data has to include: (1) data having unique identifiers relating to loan brokers or originators, (2) the nature and extent of compensation of the broker or originator, and (3) the amount of risk retention by the originator and the securitizer.

Asset-Backed Offerings

Section 943 of the Act directs the SEC to, ***not later than 180 days after the date of enactment of the Act,*** prescribe regulations on the use of representations and warranties in the asset-backed securities market to require each NRSRO to include in any report accompanying a credit rating: a description of the representations, warranties and enforcement mechanisms available to investors, and how they differ from the representations, warranties and enforcement mechanisms in issuances of similar securities. In addition, such regulations also require any securitizer to disclose fulfilled and unfulfilled repurchase requests so that investors may identify underwriting deficiencies among originators.

Section 944 of the Act eliminates the existing exemption from registration under Section 4(5) of the Securities Act which addressed certain mortgage-backed securities (e.g. involving offers or sales of one or more promissory notes directly secured by a first lien on a single parcel of real estate upon which is located a dwelling or other residential or commercial structure, and as further set out in Sections 4(5)(A) and (B) of the Securities Act).

Due Diligence and Disclosure

Section 945 of the Act amends Section 7 of the Securities Act to direct the SEC to issue, ***not later than 180 days after the date of enactment of this section of the Act***, rules relating to registration statements required to be filed by issuers of asset-backed securities to require such issuers to perform reviews of the assets underlying their securities and disclose the nature of such reviews.

The Act requires that the Chairman of the FSOC carry out a study on the macroeconomic effects of the risk retention requirements and other amendments under Subtitle D of Title IX of the Act, with emphasis on potential beneficial effects with respect to stabilizing the real estate market. The study includes the effects of risk retention on real estate asset price bubbles and involves both retroactive analysis and prospective analysis. The prospective analysis would take into consideration proactive adjustments to required risk retention percentages for creditors and securitizers and a comparable analysis of proactive adjustment of mortgage origination requirements, including assessments and recommendations for what entity could carry out such adjustments, how they should be carried out and how any related legislation should be implemented. The Chairman will issue a report to Congress on this study within 180 days of the enactment of Subtitle D.

Conflicts of Interest Provision Relating to Securitization

Section 621 of the Act provides that an underwriter, placement agent, initial purchaser, or sponsor of an asset-back security generally shall not, for one year following the closing of the securitization transaction, engage in any transaction that involves any material conflict of interest with respect to any investor in "a transaction arising out of such activity." Exemptions from this general conflicts of interest prohibition are provided for certain hedging activities and transactions in asset-backed securities made pursuant to underwriting and certain other commitments and for bona fide market-making in the asset backed security.

Risk Retention (*Skin-in-the-Game*) Requirements – Potential Upheaval of the Syndicated Lending Market Averted

As previously discussed in this memorandum, the Act contains certain risk retention provisions (colloquially referred to as "*skin-in-the-game*" provisions) that require, under Section 941, any "**securitizer**" to retain an unhedged economic interest in a portion of the credit risk of any asset that the securitizer transfers, sells or conveys to a third party. Section 941 of the Act defines the term "securitizer" as: (i) an issuer of an asset-backed security (including mortgage-backed securities); or (ii) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer. Assets, in this context, include loans.

Pursuant to the skin-in-the-game provisions of the Act, a securitizer is generally required to retain not less than five-percent of the credit risk of any asset that is transferred, sold or conveyed to a third party. Section 941, however, permits regulatory agencies to lower the 5% threshold if the originator of the assets meets underwriting standards prescribed by regulations for the asset class in question, e.g., loans. The underwriting standards, as described by Section 941 of the Act, must "ensure high quality underwriting standards for the securitizers and originators of assets…and encourage appropriate risk management practices." The regulations required by the Act also define the permissible forms of risk retention and the minimum duration of required risk retention. Pursuant to Section 941, federal government agencies responsible for promulgating these regulations and enforcing the skin-in-the-game provisions are the SEC, with respect to any securitizer that is not an insured depository institution, and the federal banking agencies, with respect to any securitizer that is an insured depository institution. Furthermore, the Act charges the Chairperson of the Oversight Council with coordinating all joint rulemaking required pursuant to these provisions. And within 180 days of enacting the Act into law, pursuant to Section 946, the Chairperson must issue a report on the study of "the macroeconomic effects of the risk retention requirements under [these provisions], and the amendments made by [these provisions], with emphasis placed on potential beneficial effects with respect to stabilizing the real estate market."

The Act has been the result of a conference committee reconciling two individual bills passed by the House of Representatives and the Senate, on December 11, 2009 and May 20, 2010, respectively. With respect to risk retention requirements, the two bills differed significantly because the House Act would have extended the skin-in-the-game provisions to all creditors and thus potentially could have had far-reaching effects on the syndicated lending market (including certain interpretations of the House Act that would have limited syndicates to a maximum of 20 lenders). Since the Act essentially adopts the Senate approach, its impact on syndicating lending should be more limited – although asset-backed loans aggregated into collateralized loan obligations (CLOs), collateralized debt obligations (CDOs) and other securitization structures will still be affected in a significant way.

E – Accountability and Executive Compensation

Say-on-Pay

New Section 14A has been added to the Exchange Act which provides that beginning with annual or other meetings of shareholders occurring six months after the Act's enactment for which the proxy solicitation rules require executive compensation disclosure, public companies are generally required to include in their proxy or consent or authorization materials for such meeting a separate non-binding resolution subject to shareholder vote (commonly referred to as "say-on-pay") to approve the compensation of executives whose compensation is required to be disclosed in such materials.

Proxy materials for any meeting of an issuer occurring more than six months after the Act's enactment at which shareholders are asked to vote on any acquisition, merger, consolidation, proposed sale or other disposition of all of the assets of an issuer are required to describe in a "clear and simple" form and in accordance with regulations to be established by the SEC, any agreements, understandings and arrangements affecting the compensation of a named executive officer of the issuer (including arrangements with an acquirer of the issuer) that is based upon or relates to such corporate events. Arrangements disclosed pursuant to this rule are generally subject to a separate non-binding shareholder vote.

The SEC may exclude issuers or classes of issuers from the voting requirements, with specific consideration given to the effect on small issuers.

The first such shareholder vote also must allow shareholders to decide whether future votes on executive compensation should occur every one, two or three years, but in all events a vote must be permitted no less than once every three years.

The provision expressly states that the required shareholder vote is not binding on the company or its board of directors, and will not be construed as (i) overruling a decision by the company or its board of directors, (ii) creating or implying any additional fiduciary duties or change in fiduciary duties of the company or its board of directors, or (iii) restricting or limiting the ability of shareholders to make other executive compensation-related proposals in proxy materials.

The SEC is directed to issue rules that require institutional investors to disclose at least annually their voting in compensation-related matters

Compensation Committee Matters

General

New Section 10C has been added to the Exchange Act, which provides that no later than 360 days after the date of the Act's enactment, the SEC must by rule direct the national securities exchanges and national securities associations to prohibit the listing of any security of a company (subject to certain exceptions noted below) that does not comply with the below rules regarding compensation committees

- The SEC rules must provide (i) procedures whereby a company will be provided with a reasonable opportunity to cure any defects that are the basis for such prohibition before the prohibition will be imposed, and (ii) that a national securities exchange or national securities association may exempt a category of companies from the below requirements as they deem appropriate, including taking into consideration the potential impact on smaller reporting companies.
- The requirements described below do not apply to any "controlled company" (i.e., a company that is listed on a national securities exchange or national securities association and that holds an election for its board of directors in which more than 50% of the voting power is held by an individual, a group or another company), or to limited partnerships, companies in bankruptcy proceedings, open-ended management investment companies that are registered under the Investment Company Act of 1940, or a foreign private issuer that provides annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee.

Independence of Compensation Committee

The SEC rules require that each member of a compensation committee of a company be a member of the board of directors and be "independent."

- SEC rules require that in establishing the independence of committee members, a national securities exchange or national securities association will consider factors that affect independence, including (i) the source of compensation of a compensation committee member, including any consulting, advisory or other compensatory fee paid by the company to such member, and (ii) whether the compensation committee

"The Act seeks greater transparency as to the company's decisions on executive compensation, including the relationship between executive compensation and company performance."

member is affiliated with the company or any of its subsidiaries or affiliates.

- A national securities exchange or national securities association may exempt a particular relationship from the above requirements as it determines is appropriate, and may take into account the size of a company and any other relevant factors.

The SEC directs national securities exchanges and national securities associations to prohibit the listing of any equity security of a company that does not comply with the above rules.

Independence of Compensation Consultants and Other Advisors

A compensation committee may only select a compensation consultant, legal counsel or other advisor to the compensation committee after considering certain factors to be established by the SEC, which include the following: (i) the provision of other services to the company by the person that employs the advisor, (ii) the amount of fees received from the company by such person as a percentage of the total revenue of such person, (iii) the policies and procedures of such person that are designed to prevent conflicts of interest, (iv) any business or personal relationship of such advisor with a member of the compensation committee, and (v) any stock of the company owned by such advisor. The independence standards established by the SEC must be competitively neutral among categories of consultants, counsel and advisors.

Compensation Committee Authority Relating to Consultants, Funding and Disclosure

A compensation committee has the authority in its discretion to engage a compensation consultant, legal counsel and other advisors, and would be directly responsible for the appointment, compensation and oversight of the work of such consultant, legal counsel and other advisors.

- The Act expressly states that these rules may not be construed to require the committee to implement or act in accordance with advice or recommendations of such consultants, counsel or advisors, or to affect the committee's right to exercise its own judgment.

Each company would be required to provide for appropriate funding, as determined by the compensation committee, for the payment of reasonable compensation to such consultant, counsel and advisors.

Beginning with annual meetings of shareholders (or special meetings in lieu thereof) occurring one year after the date of the Act's enactment, public companies would generally be required to disclose in their proxy or consent solicitation materials for a meeting whether (i) the compensation committee retained or obtained the advice of a compensation consultant, and (ii) any conflict of interest was raised by the work of such consultant and, if so, the nature of the conflict and how it is being addressed.

- The disclosure requirement does not appear to apply to independent legal counsel or other advisors.

Executive Compensation Disclosures

A new subsection (i) is added to Section 14 of the Exchange Act which provides that the SEC will enact rules pursuant to which each issuer is generally required to disclose in its annual proxy or consent solicitation materials for its annual meeting a clear description of compensation required to be disclosed under Rule 402, including information that shows the relationship between executive compensation that was actually paid (and which is required to be disclosed) and the financial performance of the company over a five-year period, taking into account any change in the value of the shares of stock and dividends of the company and any distributions.

- Such disclosure may include graphic representations of the required information.

The SEC is required to amend Rule 402 so that each public company would also generally be required to disclose (i) the median annual total compensation of all employees of the company (except the CEO), (ii) the annual total compensation of the CEO, and (iii) the ratio of the median employee annual total compensation to that of the CEO.

Clawback of Executive Compensation

A new section 10D is added to the Exchange Act that requires the SEC to direct national securities exchanges and national securities associations to prohibit the listing of companies that do not develop and implement a "clawback" policy, as described below.

- Companies are required to develop policies relating to the disclosure of incentive-based compensation that is based on financial information required to be reported under the securities laws.
- Companies are required to provide that in the event of an accounting restatement due to material noncompliance of the company with financial reporting requirements under applicable securities laws, the company will recover from any current or former executive officer any excess incentive-based compensation (including stock options) paid during the three-year period preceding the restatement that was based on erroneous data.

Employee and Director Hedging Policy Disclosure

Subsection (j) is added to Section 14 of the Exchange Act which provides that the SEC will by rule require that each public company disclose in its annual proxy or consent solicitation materials for an annual meeting whether any employee or director (or a designee of such persons) is allowed to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities that were granted to them by the company as compensation, or otherwise held by them, directly or indirectly.

- Such hedging instruments include, but may not be limited to, prepaid variable forward contracts, equity swaps, collars and exchange funds.

Excessive Compensation by Holding Companies of Depository Institutions

Subsection (i) is added to Section 5 of the BHCA of 1956 which provides that no later than 180 days after the first anniversary of the Act's enactment, the Federal Reserve, in consultation with the OCC and the FDIC, is required to establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or savings and loan holding company that (i) provides an employee, director or principal shareholder with excessive compensation, fees or benefits, or (ii) could lead to material financial loss to such holding company.

- The standards are intended to be comparable to the FDIC standards under Section 39 of the FDIA and to take into consideration the compensation standards described in Section 39(c) of the FDIA and the views and recommendations of the Comptroller of the Currency and the FDIC.

Broker Voting

Section 6(b) of the Exchange Act is amended to provide that all national securities exchanges and national securities associations are required to prohibit member brokers from voting shares on the (i) election of a director, (ii) executive compensation (which includes the "say-on-pay" vote, discussed above), or (iii) any other significant matter, as determined by the SEC, unless the brokers have received voting instructions from the beneficial owner of such shares.

F – Improvements to the Management of the Securities and Exchange Commission

Report and Certification of Internal Supervisory Controls

Section 961 requires the SEC to submit an annual report to Congress on its conduct of examinations of registered entities, enforcement investigations, and review of corporate financial securities filings. The report must contain (i) an assessment of the effectiveness of the SEC's internal supervisory controls and the procedures applicable to SEC staff who perform these examinations, investigations, and reviews; (ii) certification by the directors of the divisions of Enforcement, Corporation Finance, and Office of Compliance Inspections and Examinations; and (iii) a summary of the review conducted by the GAO of the adequacy and effectiveness of the SEC's internal supervisory control structure and examination, investigation, and review procedures.

Triennial Report on Personnel Management

Section 962 requires the GAO to submit a report to Congress once every three years on the quality of personnel management by the SEC. The report must include an evaluation of (i) the effectiveness of supervisors in using the skills, talents, and motivation of employees; (ii) the criteria for promoting employees; (iii) the fairness of the application of the promotion criteria; (iv) the competence of the professional staff; (v) initiatives to increase the competence of the staff; (vi) the efficiency of internal communication between different units of the SEC and the Commission's efforts to promote such communication; (vii) staff turnover and numbers; and (viii) actions taken against those who have not fulfilled their duties and the circumstances under which the SEC has issued a notice of termination to employees. Furthermore, the Comptroller must evaluate any improvements made by the SEC since the submission of its previous report and provide recommendations for how the Commission can more effectively and efficiently use its human resources. Within 90 days of the Comptroller's report, the SEC is required to submit a report describing the actions it has taken in response to the Comptroller's recommendations.

Annual Financial Controls Audit

Section 963 requires the SEC to submit an annual report, attested to by the Chairman and Chief Financial Officer, to Congress describing the responsibility of SEC management for establishing and maintaining an adequate internal control structure and procedures for financial reporting. The GAO will also have to submit and attest to an annual report to Congress that assesses the effectiveness of the SEC's internal control structure and procedures for financial reporting.

Report on the Oversight of National Securities Associations

Section 964 requires the GAO to submit a report to Congress two years after the date of enactment of this Act, and every three years thereafter that evaluates the SEC's oversight of SROs with respect to (i) the governance of SROs, including the identification and management of conflicts of interest and an analysis of the impact of any conflicts of interest on the regulatory enforcement or rulemaking of SROs; (ii) the examinations carried out by SROs, including the expertise of examiners; (iii) the executive compensation practices of SROs; (iv) the arbitration services provided by SROs; (v) SROs' review of members' advertising; (vi) cooperation with State securities administrators; (vii) the methods, sufficiency, and how funds are invested by SROs and the corresponding impact on regulatory enforcement; (viii) policies regarding the employment of former employees of SROs; (ix) the ongoing effectiveness of the rules of SROs; (x) the transparency of governance and activities of SROs; and (xi) any other issue the Comptroller deems has an impact on the effectiveness of SROs.

Compliance Examiners

Section 965 amends Section 4 of the Exchange Act to require the SEC's Division of Trading and Markets and Division of Investment Management to have a staff of examiners to perform compliance inspections and examinations of the entities under the jurisdiction of that division and to report to the director of that division.

Suggestion Program for Employees of the Commission

Section 966 amends the Exchange Act by inserting a new Section 4D. It would require the SEC's Inspector General to establish and maintain a confidential telephone hotline or other electronic means to receive suggestions from employees for improvements in the work efficiency, effectiveness, productivity, and use of resources of the SEC and to receive allegations of waste, abuse, misconduct, or mismanagement within the SEC. The Inspector General has to consider any suggestions or allegations, recommend appropriate action in response to such suggestions or allegations, and submit an annual report to Congress describing the suggestions

"The SEC is required to submit an annual report to Congress on its conduct of examinations of registered entities, enforcement investigations, and review of corporate financial securities filings."

or allegations made, the recommendations made or actions taken by the Inspector General, and any actions the SEC took in response to such suggestions or allegations.

Commission Organizational Study and Reform

Section 967 requires the SEC to hire an independent consultant with expertise in organizational restructuring and the operations of capital markets to examine the internal operations, structure, funding, and the need for comprehensive reform of the SEC, as well as the SEC's relationship with and the reliance on SROs and other entities relevant to the regulation of securities and the protection of securities investors that are under the SEC's oversight. The consultant must issue a report with recommendations 150 days after being retained that includes a study of (i) the possible elimination of redundant units; (ii) improving communications between SEC offices and divisions; (iii) the need to establish a clear chain-of-command structure, particularly for enforcement examinations and compliance inspections; (iv) the effect of high-frequency trading and other technological advances on the market and what the SEC requires to monitor the effect of such advances; (v) the SEC's hiring authorities, workplace policies, and personal practices; (vi) whether the SEC's oversight and reliance on SROs promotes efficient and effective governance for the securities markets; and (vii) whether adjusting the SEC's reliance on SROs is necessary. Every six months during the 2-year period following issuance of the consultant's report, the SEC must issue a report to Congress describing its implementation of the consultant's recommendations.

Study on SEC Revolving Door

Section 968 requires the GAO to conduct a study and issue a report no later than one year after the enactment of the Act that (i) reviews the number of employees who leave the SEC to work for financial institutions; (ii) determines how many employees who leave the SEC worked on cases that involved financial institutions regulated by the SEC; (iii) reviews the length of time employees work for the SEC before leaving for financial institutions; (iv) reviews the existing internal controls and makes recommendations on strengthening such controls to ensure that former SEC employees working at financial institutions did not assist such institutions in violating SEC or federal rules or regulations while employed with the SEC; (v) determines if greater post-SEC employment restrictions are necessary to prevent SEC employees from being employed by financial institutions; (vi) determines if the volume of former SEC employees employed by financial institutions has led to inefficiencies in enforcement; and (vii) makes recommendations to Congress.

G – Strengthening Corporate Governance

Proxy Access

Section 971 amends the proxy rules to give the SEC the authority to require that solicitation of a proxy, consent or authorization by an issuer includes a nominee submitted by a shareholder. The SEC will be allowed under the amendment to issue rules relating to this requirement and exempt an issuer or class of issuers from its rules. Section 971 also affirmatively permits the SEC to require that shareholders be allowed to use an issuer's proxy materials for the purpose of nominating individuals to the issuer's board of directors.

Disclosures Regarding Chairman and CEO Structures

Section 972 requires the SEC to issue rules within 180 days of the enactment of the Act requiring an issuer to disclose to its shareholders in the annual proxy sent to the issuer's investors why the issuer has either:

(1) chosen the same person to serve as chairman of the board of directors and chief executive officer (or in equivalent positions); or

(2) chosen different individuals to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer).

With respect to this section, it is unclear whether these requirements would alter the SEC's current rule that requires issuers to disclose their reasons for adopting their form of board leadership structure, including disclosures that are essentially the same as what is prescribed in the section.

"The SEC could require that shareholders be able to use an issuer's proxy materials for the purpose of nominating individuals to the issuer's board of directors."

H – Municipal Securities

Registration and Regulation of Municipal Advisors

Section 975 requires municipal advisors to register with the SEC. A municipal advisor is defined as a person who ''(i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or (ii) undertakes a solicitation of a municipal entity." The Act however, expressly excludes from the new definition (and therefore SEC jurisdiction) a broker, dealer, or municipal securities dealer serving as an underwriter, any registered investment advisor / registered commodity advisor, attorneys providing legal advice, and engineers. The Act also expressly creates a fiduciary relationship between a municipal advisor and a client, stating "A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board."

- The Act also expands the authority of the Municipal Securities Rulemaking Board (the "MSRB") to municipal advisors.
  - The MSRB will include eight "public representative" individuals who are independent of broker-dealers, municipal securities dealers, or municipal advisors and seven "regulated representatives" who are associated with broker-dealers, municipal securities dealers or municipal advisors; all of whom are to be knowledgeable of matters related to the municipal securities markets. The number of "public representatives" must at all times exceed the number of "regulated representatives."
  - The MSRB will have expanded rulemaking authority, including over advice provided to or on behalf of a municipal entity or "obligated person" by broker dealers, municipal securities dealers and municipal advisors.
  - FINRA must request guidance from the MSRB about the interpretation of MSRB rules. The MSRB, in turn, may assist the SEC or any SRO in enforcement actions conducted pursuant to the MSRB's rules.
- Section 975 defines "Municipal financial products" as municipal derivatives, guaranteed investment contracts, and investment strategies. The regulation of municipal derivatives is to be set by the municipal securities section of the Act and will apply to any municipal derivative.

Studies of Disclosure, Markets and Regulation

Sections 976 and 977 require studies of (i) the disclosure made by issuers of municipal securities; and (ii) the municipal securities market.

- The Act requires the GAO to conduct a study of the size of the municipal securities markets and the issuers and investors, and of the disclosures provided by issuers to investors. Specifically, the study (i) compares the disclosure municipal issuers are required to provide with the disclosure corporate issuers must provide, (ii) evaluates the costs and benefits to issuers and investors from requiring additional financial disclosures by municipal issuers, and (iii) makes recommendations relating to disclosure requirements for municipal issuers, including the advisability of the repeal of Section 15B(d) of the Exchange Act (commonly known as the "Tower Amendment").
- The Act also requires the GAO to conduct a study of the municipal securities markets, analyzing (i) mechanisms for trading, quality of trade executions, market transparency, trade reporting, price discovery, settlement clearing, and credit enhancements, (ii) the needs of markets and investors and the impact of recent innovations, (iii) recommendations on how to improve the transparency, efficiency, fairness, and liquidity in the municipal securities markets, and (iv) potential uses of derivatives in municipal markets. The SEC is required to respond to this report within 180 days thereafter, stating the actions the SEC had taken in response to the report.

Funding For Governmental Accounting Standards Board

Section 978 establishes that the Government Accounting Standards Board ("GASB") will be funded by assessing entities registered with the SEC "a reasonable annual accounting support fee." The Section further defines the role and importance of the Government

"Municipal securities advisers (e.g., persons who advise municipal entities) have to register with the SEC."

Accounting Standards Board ("GASB"), and requires a study by the SEC that evaluates the role and importance of the GASB in municipal securities markets, including with respect to the board's funding. The SEC will submit this report to Congress within 180 days after enactment of the Act.

Creation of Office of Municipal Securities.

Section 979 creates an Office of Municipal Securities within the SEC to administer SEC rules with respect to municipal securities and to coordinate with the MSRB for rulemaking and enforcement actions. The director of the Office of Municipal Securities will report to the chairman of the SEC.

I – Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters

The Act makes a number of changes to expand the role and function of the PCAOB.

Foreign Oversight Authorities

Section 981 authorizes the PCAOB to share information with any non-US auditor oversight authority (defined as any governmental body or other entity empowered by a non-US government to inspect or enforce laws relating to public accounting firms) without that information losing its privileged status. The PCAOB may share this information, if, among other things, it finds that collaboration is necessary to protect investors, and if the foreign auditor oversight authority provides assurances of confidentiality

Auditors of Broker-Dealers

Section 982 gives the PCAOB the authority to inspect registered public accounting firms that audit brokers and dealers (unless they are found to be exempt from the program), as well as issuers (as is currently the case). It also requires auditors of brokers and dealers to register with the PCAOB and to pay an annual accounting support fee to the PCAOB. Finally, the PCAOB will be permitted to refer investigations to an SRO with jurisdiction over the relevant broker or dealer.

Portfolio margining

Section 983 adds portfolio margining accounts carried as securities accounts pursuant to a portfolio margining program approved by the SEC to the definition of "Customer Property" found in the Securities Investor Protection Act of 1970.

Securities Lending

Under Section 984, the SEC is required to promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors with respect to securities lending.

Council of Inspectors General of Financial Oversight

Section 987 establishes a Counsel of Inspectors General On Financial Oversight (the "Council").

- The Council will be chaired by the Inspector General of the Department of the Treasury and composed of the inspectors general of the (i) Board of Governors of the Federal Reserve System, (ii) the Commodity Futures Trading Commission, (iii) the Department of Housing and Urban Development, (iv) the Department of the Treasury, (v) the Federal Deposit Insurance Corporation, (vi) the Federal Housing Finance Agency, (vii) the National Credit Union Administration, (viii) the SEC, and (ix) the Troubled Asset Relief Program.
- The purpose of the Council is to facilitate the sharing of information among inspectors general, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight.
- In addition, agency heads, including the Chair of the SEC, are required under Section 989H to address deficiencies identified in any Inspector General report, or certify to both Houses of Congress that no action is necessary.
- Section 988 requires the Inspector General to conduct a review when a share insurance fund experiences losses. The report must include (i) a description of the reasons why the problems of the credit union resulted in a material loss to the Fund; and (ii) recommendations for preventing any such loss in the future.

Senior Investor Protections

Section 989A establishes a program under which the Office of Financial Literacy of the Bureau may make grants to States and State securities, insurance and consumer protection agencies to assist in identifying, investigating and prosecuting cases involving misleading or fraudulent marketing of financial products.

Exemption For Nonaccelerated Filers

Section 989G, in addition to creating an exception to Section 404 of the Sarbanes-Oxley Act of 2002 for non-accelerated filers, also instructs the SEC to "conduct a study to determine how the Commission could reduce the burden of complying with section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose market capitalization is between $75,000,000 and $250,000,000 for the relevant reporting period while maintaining investor protections for such companies."

"A Council of Inspectors General of Financial Oversight will be formed to facilitate the sharing of information among inspectors general (including representatives from the SEC and CFTC), with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight."

GAO Study Regarding Exemption For Smaller Issuers

Section 989I mandates that the GAO shall carry out a study on the impact of the amendments made by this Act to section 404(b) of the Sarbanes-Oxley Act of 2002, including:

- Whether issuers that are exempt from such section 404(b) have fewer or more restatements of published accounting statements than issuers that are required to comply with such section 404(b);
- The cost of capital for issuers that are exempt from such section 404(b) compared to the cost of capital for issuers that are required to comply with such section 404(b);
- Whether there is any difference in the confidence of investors in the integrity of financial statements of issuers that comply with such section 404(b) and issuers that are exempt from compliance with such section 404(b);
- Whether issuers that do not receive the attestation for internal controls required under such section 404(b) should be required to disclose the lack of such attestation to investors; and
- The costs and benefits to issuers that are exempt from such section 404(b) that voluntarily have obtained the attestation of an independent auditor.

Promoting the Adoption of Certain NAIC Model Regulations

Finally, Section 989J adopts a number of provisions intended to promote the adoption of model regulations enhancing the protection of seniors and other consumers in the context of certain insurance and annuity policies.

J – Securities and Exchange Commission Match Funding

Section 991 amends section 31 of the Exchange Act to require the SEC to collect transaction fees and assessments designed to cover the costs to the government of the annual appropriation to the SEC by Congress. The SEC must adjust its fee rates to a uniform adjusted rate that is reasonably likely to produce aggregate fee collections equal to the regular appropriation to the SEC by Congress for that fiscal year. By March 1 of the fiscal year the SEC must determine whether, based on the actual aggregate dollar volume of sales during the first 5 months of the fiscal year, the baseline estimate used is reasonably likely to be 10 percent (or more) greater or less than the actual aggregate dollar volume of sales for the fiscal year. If the SEC so determines, it must adjust the rates to a uniform adjusted rate that, for the remainder of the year, is reasonably likely to produce aggregate fee collections equal to the regular appropriation to the SEC by Congress for the fiscal year. In making its revised estimate, the SEC must consult with the Congressional Budget Office and the Office of Management and Budget.

Beginning in fiscal year 2012, and each fiscal year thereafter, subtitle J will amend section 35 of the Exchange Act (Authorization of Appropriations) to require the SEC to prepare and submit a budget to the President and copies of the budget to Congress. The President must submit each budget submitted by the SEC to Congress in unaltered form along with the annual budget for the Administration submitted by the President. The SEC's requested budget must contain (i) an itemization of the amount of funds necessary to carry out the functions of the SEC; (ii) an amount to be designated as contingency funding to address unanticipated needs; and (iii) a designation of any activities for which multi-year budget authority would be suitable. Additionally, the Act establishes an SEC reserve fund, which the SEC is able to use for any function it determines is necessary to carry out its functions. The amount deposited in the fund may not exceed $50,000,000 each year, and the balance in the fund may not exceed $100,000,000. Any excess fees the SEC collects from registration fees must be deposited in the general fund of the Treasury and are not available to the SEC.

Title X.
Bureau of Consumer Financial Protection

Bureau of Consumer Financial Protection

Establishment

Title X of the Act, under the heading "Bureau of Consumer Financial Protection", also called the "Consumer Financial Protection Act of 2010", establishes in the Federal Reserve System an independent bureau to be known as the "Bureau of Consumer Financial Protection" (the "Bureau"). The Bureau is an executive agency and regulates the offering and provision of consumer financial products or services under the federal consumer financial laws. The Bureau seeks to implement and, where applicable, enforce federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent and competitive.

Independence

Notwithstanding being situated in the Federal Reserve System, the Bureau is essentially autonomous. The Bureau is an executive agency whose director (the "Director") is nominated by the President and confirmed by the Senate. Notwithstanding the Federal Reserve Act, the Board of Governors of the Federal Reserve System would not be able to (i) intervene in any matter or proceeding before the Director, including examinations or enforcement actions, unless otherwise specifically provided by law; (ii) appoint, direct, or remove any officer or employee of the Bureau; (iii) merge or consolidate the Bureau, or any of the functions or responsibilities of the Bureau, with any division or office of the Board of Governors or the Federal Reserve banks; (iv) approve or review any rule or order of the Bureau; or (v) delay or prevent the issuance of any rule or order of the Bureau. In addition to fulfilling other interim reporting requirements to Congress, the Director presents a semi-annual report to the President and to Congress on, and is required to appear before Congress concurrently with the submission of the report to discuss, the significant problems faced by consumers in shopping for or obtaining consumer financial products and services, the Bureau's budget request, rules and orders adopted by the Bureau, complaints collected by the Bureau, various actions taken and analyses of the Bureau's efforts in accomplishing its mission and in increasing workforce and contracting diversity.

Funding of Bureau and Authorization of Appropriations for 2010-2014

The Federal Reserve System is required to fund the Bureau each year in the determination of the Director, not to exceed a set percentage of its earnings for such period, but the Bureau's financial statements are not consolidated with those of the Federal Reserve System. The Act authorizes the appropriation of $200 million for each of fiscal years 2010-2014 if the Director determined that such funds were necessary and submitted a report to the President and Congress regarding the funding of the Bureau and the extent to which its funding needs exceeds its actual funding.

Objectives

The Act authorizes the Bureau to exercise its authorities under federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services: (i) consumers are provided with timely and understandable information to make responsible decisions about financial transactions; (ii) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination; (iii) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens; (iv) federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and (v) markets for consumer financial products and

Unfair or Abusive?

The Bureau will be able to prescribe rules applicable to a covered person or service provider identifying and prohibiting as unlawful unfair, deceptive or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.

An act or practice will not be ruled unfair unless the Bureau has a reasonable basis to conclude that (i) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers and (ii) such substantial injury is not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Bureau may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations would not be able to serve as a primary basis for such determination.

An act or practice will not be ruled abusive unless it (i) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or (ii) takes unreasonable advantage of (a) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service, (b) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service or (c) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

services operate transparently and efficiently to facilitate access and innovation.

Federal Consumer Financial Law

All authority to prescribe rules or issue orders or guidelines pursuant to any federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders and guidelines, and the examination authority concomitant thereto, held by the Board of Governors (and any Federal Reserve bank, as the context requires), the Federal Deposit Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Department of Housing and Urban Development, and the heads of those agencies, is transferred to the Bureau. No such authority is transferred from the Federal Trade Commission Act.

Consumer Financial Products and Services

Consumer financial products and services means financial products and services offered or provided for use by consumers primarily for personal, family or household purposes. Such financial products and services include, but are not limited to: extending credit and servicing loans; extending or brokering leases of personal or real property; providing real estate settlement services or performing appraisals of real estate or personal property; engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer; selling, providing or issuing stored value (excluding prepaid special purpose cards or certificates issued in a specified amount by a merchant, retailer or other seller of nonfinancial goods or services) or payment instruments; providing check cashing, check collection, or check guaranty services; and providing payments or other financial data processing products or services to a consumer by any technological means. The Act specifically excludes from such definition the business

Covered Persons

Supervision of Nondepository Covered Persons

The Bureau requires reports and conduct examinations on a periodic basis of any covered person who (i) originates or brokers consumer real-estate secured loans, (ii) is a "larger participant of a market for other consumer financial products or services," as defined by rulemaking of the Bureau in consultation with the Federal Trade Commission (the "FTC"), (iii) offers or provides to a consumer any private education loan, (iv) offers or provides to a consumer a payday loan or (v) the Bureau has reasonable cause, based on complaints collected through the system under the Act, to determine, by order, after notice to the covered person and a reasonable opportunity for the covered person to respond, has engaged in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services, for purposes of (a) assessing compliance with the requirements of federal consumer financial law, (b) obtaining information about the activities and compliance systems or procedures of such person and (c) detecting and assessing risks to consumers and to markets for consumer financial products and services. Among the factors that the Bureau would take under consideration in its rulemaking is the asset size of the covered person, the volume of transactions involving consumer financial products or services in which the covered person engages, the risks to consumers created by the provision of such consumer financial products or services and the extent to which such institutions are subject to oversight by State authorities for consumer protection. The Bureau and the FTC would coordinate enforcement actions.

Supervision of Very Large Banks, Savings Associations and Credit Unions

The Bureau has exclusive authority to require reports and conduct examinations on a periodic basis of any covered person that is (i) an insured depository institution with total assets of more than $10 billion and any affiliate thereof or (ii) an insured credit union with total assets of more than $10 billion and any affiliate thereof for purposes of (a) assessing compliance with the requirements of federal consumer financial laws, (b) obtaining information about the activities subject to such laws and the associated compliance systems or procedures of such persons and (c) detecting and assessing risks to consumers and to markets for consumer financial products and services. The Bureau would have primary enforcement authority.

Supervision of Other Banks, Savings Associations and Credit Unions

The Director is able to require reports from any covered person that is (i) an insured depository institution with total assets of $10 billion or less or (ii) an insured credit union with total assets of $10 billion or less, as necessary to support the role of the Bureau in implementing federal consumer financial law, to support its examination activities, and to assess and detect risks to consumers and consumer financial markets. Other than requiring such reports, the prudential regulator would have primary authority to enforce the federal consumer financial laws with respect to such covered person.

of insurance or electronic conduit services. The "business of insurance" means the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons.

"The Bureau is permitted to promulgate rules requiring the registration of covered persons, other than an insured depository institution, insured credit union or related person."

Functions

Generally

The primary functions of the Bureau are: (i) conducting financial education programs through the establishment of an Office of Financial Education; (ii) collecting, investigating and responding to consumer complaints; (iii) collecting, researching, monitoring and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets; (iv) generally supervising covered persons for compliance with federal consumer financial law and taking appropriate enforcement action to address violations of federal consumer financial law; (v) issuing rules, orders, and guidance implementing federal consumer financial law; and (vi) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau.

Office of Financial Education

The newly established Office of Financial Education's mandate to improve the financial literacy of consumers includes providing opportunities for consumers to access: (i) financial counseling, (ii) information to assist with the evaluation of credit products and the understanding of credit scores, (iii) savings, borrowing and other services found at mainstream financial institutions, (iv) activities for consumers (a) to prepare for educational expenses and the submission of financial aid applications, and other major purchases, (b) reduce debt and (c) improve their financial situation, (v) assistance in developing long-term savings strategies and (vi) wealth building and financial services during the preparation process to claim earned income tax credits and federal benefits.

Telephone Hotline and Website for Consumer Complaints

Consumer complaints are collected and tracked using a single, toll-free telephone number, a website and a centralized database. Complaints would be directed to various Federal and State agencies, as appropriate.

Office of Fair Lending and Equal Opportunities

Within the Bureau, the newly established Office of Fair Lending and Equal Opportunity has the power to oversee and enforce federal laws intended to ensure the fair, equitable and nondiscriminatory access to credit for individuals and communities that are enforced by the Bureau; coordinate fair lending efforts of the Bureau with other federal agencies and State regulators to promote consistent, efficient and effective enforcement of federal fair lending laws; work with private industry, fair lending, civil rights, consumer and community advocates on the promotion of fair lending compliance and education; and provide annual reports to Congress on the efforts of the Bureau to fulfill its fair lending mandate.

Office of Service Member Affairs

A newly established Office of Service Member Affairs is responsible for initiatives specifically directed at service members and their families in connection with consumer financial products and services.

Office of Financial Protection for Older Americans

A newly established Office of Financial Protection for Older Americans would be responsible for implementing activities designed to facilitate the financial literacy of individuals who are at least 62 years old on protection from unfair, deceptive and abusive practices and on current and future choices.

Consumer Advisory Board

A newly established Consumer Advisory Board advises and consults with the Bureau in the exercise of its functions under the federal consumer financial laws and provides information on emerging practices in the consumer financial products or services industry, including regional trends, concerns and other relevant information. Members of the Consumer Advisory Board are appointed by the Director and include experts in consumer protection, financial services, community development, fair lending and civil rights, and consumer financial products or services. Such members also include representatives of depository institutions that primarily serve underserved communities and representatives of communities that have been significantly impacted by higher priced mortgage loans.

"The Bureau also has access to any report of examination or financial condition made by a prudential regulator or other Federal agency having jurisdiction over a covered person or service provider."

Covered Persons

Covered person under the Act means any person that engages in offering or providing a consumer financial product or service and any affiliate of such person if such affiliate acts as a service provider to such person.

Rulemaking Authority

The Act provides the Bureau with rulemaking authority as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the federal consumer financial laws, and to prevent evasions thereof. In making such rules, it is required to consider the potential costs and benefits to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products, and the impact of proposed rules on both covered persons and consumers in rural areas. The Bureau is able, by rule, conditionally or unconditionally to exempt any class of covered persons, service providers or consumer financial products or services from any provision of the Consumer Financial Protection Act of 2010 or from any rule promulgated thereunder, as the Bureau determines necessary or appropriate, taking into consideration the total assets of the class of covered persons, the volume of transactions involving consumer financial products or services in which the class of covered persons engages and existing provisions of law which are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections. The Bureau is permitted to promulgate rules requiring the registration of covered persons, other than an insured depository institution, insured credit union or related person.

Collection of Information from Covered Persons

In order to support its rulemaking and other functions, the Bureau monitors the offering and provision of consumer financial products and services for risks to consumers, the results of which monitoring the Bureau will report annually. In order to conduct such monitoring, the Bureau has the authority to gather information from time to time regarding the organization, business conduct, markets and activities of covered persons and service providers. In order to gather such information, the Bureau is able to utilize a variety of sources, including examination reports concerning covered persons and service providers, surveys and interviews with covered persons and service providers, and available databases, and is able to require covered persons and service providers participating in consumer financial services to file with the Bureau, as the Bureau may prescribe by rule or order, annual or special reports, or answers in writing to specific questions, furnishing information. The Bureau also has access to any report of examination or financial condition made by a prudential regulator or other Federal agency having jurisdiction over a covered person or service provider.

Review of Bureau Regulations

On the petition of a member agency of the Council, the Council may stay the effectiveness of, or set aside and thereby render unenforceable, a final regulation prescribed by the Bureau, or any provision thereof, but only if the Council decides that the regulation or provision would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk. The Council also has to overcome high procedural bars (including a two-thirds vote) to stay or set aside any rulemaking by the Bureau.

Classes Excluded from Authority of Bureau

The Bureau may not exercise any rulemaking or other authority with respect to: merchants, retailers and other sellers of nonfinancial goods and services; licensed or registered real estate brokers or real estate agents; manufactured home retailers and modular home retailers; accountants and tax preparers; attorneys as part of the practice of law under the laws of a State in which the attorney is licensed to practice law; persons regulated by a State insurance regulator; employee benefit plans; any specified plan or arrangement (meaning any plan, account, or arrangement described in section 220, 223, 401(a), 403(a), 403(b), 408, 408A, 529, or 530 of the Internal Revenue Code of 1986 (the "Code"), or any employee benefit or compensation plan or arrangement, including a plan that is subject to title I of the Employee Retirement Income Security Act of 1974, or any prepaid tuition program offered by a State); persons engaged in the activity of establishing or maintaining for the benefit of the employees of such person any specified plan or arrangement; persons engaged in the activity of establishing or maintaining a qualified tuition program under Section 529 of the Code; persons regulated by a State securities commission (i.e., no preemption of State law, except where such State law is inconsistent with the proposed statute); persons regulated by the SEC or the Commodity Futures Trading Commission; persons regulated by the Farm Credit Administration; activities relating to charitable contributions; the business of insurance; any authority arising under the Fair Housing Act; or any motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, and/or the leasing and servicing of motor vehicles.

Studies

Among the other, numerous studies that are required under the Act, the Act requires the GAO to conduct a study within one year of the Act's enactment on the effectiveness and impact of (i) various appraisal methods, including the cost approach, the comparative sales approach, the income approach, and other methods that may be available and (ii) the Home Valuation Code of Conduct. The Act also requires the Secretary of the Treasury to study ending the conservatorship of Fannie Mae, Freddie Mac and reforming the housing finance system and to submit such study to Congress no later than January 31, 2011.

Victims Relief Fund

The Act establishes a Consumer Financial Civil Penalty Fund in the Federal Reserve, into which would be deposited any civil penalties from any judicial or administrative action under Federal consumer financial laws. Any amounts therein are paid to victims of Federal consumer financial laws or, to the extent such victims cannot be located or such payments are otherwise not practicable, the Bureau may use such funds for the purpose of consumer education and financial literacy programs.

Title XI. Federal Reserve Provisions

Federal Reserve Provisions

Amendments to Emergency Lending Authority

The Act amends Section 13 of the Federal Reserve Act ("FRA") to prohibit the Federal Reserve from extending credit in unusual and exigent circumstances to an individual, partnership, or corporation other than through a "program or facility with broad-based eligibility." Section 13 is also amended to require the Federal Reserve to establish by regulation, in consultation with the Secretary of the Treasury, policies and procedures governing emergency lending programs or facilities. The relevant regulation should ensure that the emergency lending program or facility is for the purpose of providing liquidity to the financial system as a whole, rather than assistance to individual failing institutions. The regulations shall also prescribe a "lendable value" of collateral designed to protect taxpayers from losses.

The Federal Reserve shall establish procedures to ensure that insolvent institutions have no access to emergency lending programs and facilities. Such procedure may include a certification from the CEO of the institution (or other authorized officer) that the institution is not insolvent.

The Federal Reserve is prohibited from establishing an emergency lending program or facility without the prior approval of the Secretary of the Treasury. The Federal Reserve shall also provide a report to the Congressional banking committees, no later than 7 days after authorizing an emergency lending program. The report shall include: (i) justification for the assistance; (ii) identity of recipients; (iii) the date and amount of the assistance, and form in which the assistance was provided; and (iv) the material terms of the assistance (i.e., duration, collateral, interest, fees, corporate governance requirements imposed, expected cost to the taxpayers). The Federal Reserve shall also provide written updates once every 30 days on: (i) the value of collateral securing the assistance; (ii) interest and other revenue received under the program or facility; and (iii) the expected cost to the taxpayer.

Review of Special Federal Reserve Credit Facilities

The Act authorizes the GAO to conduct reviews, including on-site examinations of the Federal Reserve, any open market transaction or discount window advance that meets the definition of "covered transaction" in Section 11(s) of the FRA ("covered transactions"), and any program or facility, including any SPV or other entity, established by or on behalf of the Federal Reserve (a "credit facility") pursuant to Section 13 of the FRA, if the GAO determines that such reviews are appropriate. Such reviews may be performed solely for the purposes of assessing: (i) the operational integrity, accounting, financial reporting, and internal controls of the credit facility or covered transaction; (ii) effectiveness of the relevant collateral policy; (iii) any bias in favor of any participants; and (iv) the policies governing third party contractors. The GAO shall report to Congress within 90 days after completing a review. The GAO shall not disclose to any person or entity the identifying details of and information about specific participants in a credit facility; such information shall be redacted in reports submitted to Congress. The GAO shall release non-redacted versions of any report on a credit facility one year after the effective date of termination of the credit facility. The GAO shall release a non-redacted version of any report regarding covered transactions upon the release of the information regarding such covered transactions by the Federal Reserve as provided in Section 11(s) of the FRA.

The Act also provides that the Federal Reserve shall publicly disclose: (i) the names and identifying details of each borrower, participant or counterparty in any credit facility or covered transaction; (ii) the amount borrowed by or transferred by or to a specific borrower, participant or counterparty in any credit facility or covered transaction; (iii) the interest rate or discount paid by each borrower, participant or counterparty in any credit facility or covered transaction; and (iv) information identifying the types and amounts of collateral pledged or assets transferred in connection with participation in any credit facility or covered transaction. Such disclosure shall be made one year after the effective date of the termination by the Federal Reserve of the authorization of the credit facility and, in the case of a covered transaction, on the last day of the eighth calendar quarter following the calendar quarter in which the covered transaction was conducted. The Federal Reserve is authorized to make such disclosure before the time specified above if it determines that such disclosure is in the public interest and would not harm the effectiveness of the relevant credit facility or the purpose or conduct of covered transactions.

"The Act amends Section 13 of the Federal Reserve Act to prohibit the Federal Reserve from extending credit in unusual and exigent circumstances to an individual, partnership, or corporation other than through a "program or facility with broad-based eligibility."

Emergency Financial Stabilization Programs

Upon written determination of the FDIC and the Federal Reserve, the FDIC shall create a widely available program to guarantee the obligations of solvent insured depository institutions or insured depository institution holding companies (including their affiliates) during times of severe economic distress, except that such program may not include the provision of equity in any form. The Secretary of the Treasury may request the Federal Reserve and the FDIC to determine whether liquidity conditions exist that warrant the use of an emergency stabilization program. The GAO shall review and report to Congress on any determination to create an emergency stabilization program.

The maximum amount of any such guarantee shall be determined by the Secretary of the Treasury in consultation with the President and must be approved by a joint resolution of Congress. An increase in the maximum amount authorized should also be approved by the Council.

The FDIC shall establish by regulation, in consultation with the Secretary of the Treasury, policies and procedures governing the issuance of emergency guarantees. The FDIC shall charge assessments to all participants in the program to offset projected and actual losses and administrative expenses. The FDIC may not borrow from the Deposit Insurance Fund in connection with an emergency stabilization program but may borrow funds from the Treasury.

The Act revokes the existing FDIC authority pursuant to Section 13(c) of the FDIA to establish any widely available debt guarantee program for which the Act provides authority.

> "Upon written determination of the FDIC and the Federal Reserve the FDIC shall create a widely available program to guarantee the obligations of solvent insured depository institutions or insured depository institution holding companies (including their affiliates) during times of severe economic distress, except that such program may not include the provision of equity in any form."

The FDIC shall be authorized to appoint itself as a receiver for any insured depository institution participating in an emergency stabilization program that defaults on any obligation guaranteed by the FDIC. With respect to a participant company in default that is not an insured depository institution the FDIC may: (i) require consideration of whether the company shall be resolved under the resolution authority provided for under the Act; or (ii) require that the company file a petition for bankruptcy or file a petition for involuntary bankruptcy on behalf of the company.

Federal Reserve Governance Amendments

The FRA is amended to require that the presidents of the Federal Reserve banks shall be appointed by the Class B and Class C directors of the banks, for a five year term. Class B directors consists of three members, who represent the public. Class C directors consist of three members designated by the Board of Governors of the Federal Reserve System. Class A directors chosen by and representative of the stockholding banks shall no longer be able to vote for the appointment of the president.

The Act amends the FRA to require the appointment of a second Vice Chairman of the Board of Governors of the Federal Reserve who shall be designated as "Vice Chairman of Supervision."

The Act also amends the FRA to explicitly authorize the Federal Reserve to "identify, measure, monitor, and mitigate risks to financial stability of the United States." Further, the Board of Governors of the Federal Reserve shall not delegate to a Federal Reserve bank its functions for the establishment of policies for the supervision and regulation of firms supervised by it.

No later than one year after the enactment of the Act, the GAO shall audit the governance of the Federal Reserve bank system. The GAO shall also conduct an audit of all financial assistance provided by the Federal Reserve during the period from December 1, 2007, until the enactment of the Act.

The Act requires the Federal Reserve to publish on its website information about the financial assistance it has provided during the period from December 1, 2007, until the enactment of the Act, including: (1) the identity of each entity to which the Board of Governors has provided such assistance; (2) the type of financial assistance provided; (3) the value or amount of that financial assistance; (4) the date on which the financial assistance was provided; (5) the specific terms of any repayment expected, including the repayment time period, interest charges, collateral, limitations on executive compensation or dividends, and other material terms; and (6) the specific rationale for each such facility or program.

Title XII.
Improving Access to Mainstream Financial Institutions

Improving Access to Mainstream Financial Institutions

Section 1202 encourages initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream.

Expanded Access to Mainstream Financial Institutions

Section 1204 authorizes the Treasury Secretary to establish a multiyear program of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings to promote initiatives designed to (i) enable low- and moderate-income individuals to establish accounts in a federally insured depository institution; and (ii) improve access to the provision of accounts on reasonable terms for such individuals. Participation in this program is restricted to eligible entities, which include 501(c)(3) organizations, federally insured depository institutions, community development financial institutions, a State, local, or tribal government entity, or a partnership or joint venture of one of these entities. The Treasury enacts regulations governing program implementation and the products and services to be offered, including small-dollar value loans and financial education and counseling relating to conducting transactions in, and managing, accounts.

Low-Cost Alternatives to Small Dollar Loans

Section 1205 authorizes the Treasury Secretary to establish multiyear demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings with eligible entities to provide low-cost, small loans to consumers that provide alternatives to more costly small dollar loans. Loans under this section must be made on terms and conditions, and pursuant to lending practices, that are reasonable for consumers. Furthermore, eligible entities awarded a grant under this section are required to take steps to ensure the provision of financial literacy and education opportunities to each consumer provided with a loan.

Grants to Establish Loan-Loss Reserve Funds

Section 1206 amends the Community Development Banking and Financial Institutions Act of 1994. It would permit the Community Development Financial Institutions Fund to provide funds to help community development financial institutions establish their own loan loss reserve funds to defray the costs and mitigate the losses of operating small dollar loan programs, which are consumer loans not exceeding $2,500, are repaid in installments, and have no pre-payment penalty, among other conditions. Community development financial institutions must provide non-federal matching funds in an amount equal to 50 percent of the amount of any grant received. Grants may not be used to provide direct loans to consumers. However, grants may be used to recapture a portion or all of a defaulted loan made under such an institution's small dollar loan program, or to designate and utilize a fiscal agent for services. This section also permits the Fund to make technical assistance grants for technology, staff support, and other costs associated with establishing a small dollar loan program.

Evaluation and Reports to Congress

Section 1210 requires the Treasury Secretary to submit a report to Congress for each fiscal year in which a program or project is carried out under this title containing a description of the activities funded, amounts distributed, and measurable results.

"The Act establishes multiyear demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings with eligible entities to provide low-cost, small loans to consumers that provide alternatives to more costly small dollar (e.g., "payday") loans."

Title XIII.
Pay It Back Act

Pay It Back Act

TARP Amendment

Title XIII, the "Pay It Back Act" amends the Emergency Economic Stabilization Act of 2008 to reduce Troubled Assets Relief Program authorization to $475 billion, provided that the Secretary of the Treasury is able, with the concurrence of the Board of Governors of the Federal Reserve System, to purchase troubled assets in an amount equal to amounts received by the Secretary before, on or after the date of enactment of the Pay It Back Act for repayment of the principal of financial assistance by an entity that has received financial assistance under the TARP, but only (i) to the extent necessary to address what the Secretary has determined to be an immediate and substantial threat to the economy arising from financial instability and (ii) upon transmittal of such determination, in writing, to the appropriate committees of Congress.

Deficit Reduction

The Pay It Back Act causes the Secretary of the Treasury to apply (i) all proceeds from the sale of any obligations of Fannie Mae and Freddie Mac and any federal home loan bank obligations, (ii) any funds provided to any State by the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") that were rejected by such State and (iii) certain other recaptured, returned and repaid funds solely towards deficit reduction and prohibits the Secretary from using such proceeds and funds to offset other spending increases or revenue reductions. Such recaptured funds include funds the appropriation of which is permitted under the Recovery Act and the Recovery Act is amended to rescind any such appropriations that are not obligated by December 31, 2012, provided that the President is able to waive any such rescission if the President determines that it is not in the best interest of the Nation to rescind a specific, unobligated amount.

Title XIV. Mortgage Reform and Anti-Predatory Lending Act

Mortgage Reform And Anti-Predatory Lending Act

Summary of Provisions

The Mortgage Reform and Anti-Predatory Lending Act (the "Act") is a response to the residential mortgage crisis and perceived predatory lending practices, foreclosure scams and a lack of public education on the financial risks of homeownership. The Act provides support for homeowners throughout the home buying and ownership process, including obtaining a mortgage, refinancing, disputes with lenders and possible foreclosures. The Act also requires the completion of several studies and the creation of new programs. The regulations required to give effect to the various provisions of the Act, however, will take effect within two and a half years.

Obtaining a Mortgage

The Act, which amends, among other statutes, the Truth in Lending Act (15 U.S.C. 1631 *et seq.*) notes that the purpose of the changes to mortgage loan origination is to "assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." In that regard, the Act requires that all "mortgage originators" be qualified and be prohibited from receiving financial compensation not tied to the amount of the principal (i.e., prohibition on "steering incentives").

The Act requires that regulations be enacted that would prohibit a mortgage originator from steering any consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay, does not provide the consumer with a net tangible benefit, or that has predatory characteristics or effects, such as excessive fees. The Act furthers require the regulation of mortgage originators to refrain from abusive or unfair lending practices or mischaracterizing the residential mortgage loans available to the consumer.

The Act places an emphasis on the role of the creditor in ensuring that the consumer has the ability to repay the residential mortgage loan. The creditor is required to make a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan according to the terms of the loan. The creditor, in making this determination, can consider the consumer's credit history, current income and other debt obligations, but the ability to repay must take into account multiple loans and the fully amortized value of the loan over the term of the loan.

The Act requires that the creditor provide periodic statements to the consumer regarding, among other things, the amount of the principal obligation, current interest rate, late payment fees and contact details for obtaining information regarding the mortgage.

The Act specifically addresses both "high-cost mortgages" and "higher-risk mortgages." In relation to high-cost mortgages, the Act prohibits offering such a mortgage without providing the consumer with pre-loan counseling, imposing "balloon payments" (i.e., payment that is twice as large as the prior scheduled payment) and restricts refinancing. With regard to subprime mortgages, prior to offering such a mortgage a creditor must first obtain and bear the cost of a written appraisal of the property.

Refinancing

In considering whether a consumer can refinance his or her residential mortgage, the creditor must reasonably and in good faith determine that the refinanced loan will provide a "net tangible benefit" to the consumer, although the Act defers on how such benefit is to be calculated or measured.

The Act also provides for a prohibition on prepayment penalties, except for with certain "qualified mortgages." Further, the Act requires a creditor who offers a consumer a residential mortgage that includes prepayment penalties to also offer to the consumer a residential mortgage that does not include prepayment penalties. Likewise, the creditor must provide the consumer with information regarding the acceptance of partial payments and must, except in limited circumstances, ensure that consumer payments are credited to the consumer's account on the date received.

Disputes with Lenders

The Act specifically addresses arbitration in the context of disputes between consumers and lenders, and provides that no residential mortgage loan or extension of credit that is secured by a principal dwelling may include terms which require arbitration or other non-judicial procedures as a method for resolving disputes. The Act does, however, allow for the parties to agree to arbitration after a dispute has arisen. The Act also notes that no provision of any residential mortgage loan shall be construed as a bar to a consumer bringing an action in an appropriate court of competent jurisdiction.

A mortgage originator found liable for a breach of the Act is required to pay to the consumer actual damages or three times the total of the compensation (direct or indirect) to the mortgage originator plus costs and reasonable attorney fees.

Foreclosure

The Act allows a consumer to raise a violation by the creditor of certain provisions of the Truth in Lending Act, including the proposed revisions relating to mortgage origination as a defense in foreclosure proceedings. The Act also includes a provision for establishing a program for making grants to those who are providing foreclosure legal assistance to low- and moderate-income homeowners and tenants; however the funding cannot be used in connection with class actions.

Impact Studies and New Initiatives

The Act requires that numerous studies be conducted, including a study by the GAO on the effects of the enactment of the Act on the availability and affordability of credit for consumers, small business, homebuyers and mortgage lending; a study by the Secretary of Housing and Urban Development on the root causes of default and foreclosures and the creation of a database on foreclosures and defaults that will be made publicly available, but with provisions for ensuring the confidentiality of personally identifiable information; a study by the GAO on possible improvements to the appraisal process; a GAO study report on government efforts to combat mortgage foreclosure rescue scams and loan modification fraud; and a study on the effect of drywall presence on foreclosures.

The Act also seeks the creation of the Office of Housing Counseling, which will provide counseling relating to homeownership and residential mortage loans as well as grants to other organizations that will offer such counseling services, a process for certifying various computer software programs for consumers to use in evaluating different residential mortgage loan proposals, and foreclosure rescue education programs. The Secretary of Housing and Urban Development will also be tasked with informing homebuyers of the importance of obtaining an independent home inspection. In addition, the Secretary will be required to spend 10% of the funds received to assist the Neighborhood Reinvestment Corporation, whose mandate is to assist with foreclosures and to protect consumers from foreclosure rescue scams. In addition, the Act requires the creation of a Multifamily Mortgage Resolution Program, designed to protect renters.

Title XV.
Miscellaneous

Miscellaneous

Restriction on use of US Funds for non-US Governments

Section 1501 of the Act amends The Bretton Woods Agreements Act, the legislation controlling the United States' relationship with the International Monetary Fund ("IMF"). The amendment requires the United States Executive Director of the IMF to evaluate proposed loans to a country whose public debt exceeds its gross domestic product and is not eligible for assistance from the International Development Association. If the evaluation indicates that a proposed loan is not likely to be repaid in full, the US Executive Director at the IMF will oppose the proposal. If the IMF does grant loan proposals to a country meeting the conditions described above, the Secretary of the Treasury shall annually report to Congress the likelihood that the loans made pursuant to such a proposal will be repaid in full.

Congo Conflict Minerals

Section 1502 of the Act regulates the exploitation and trade of columbite-tantalite, cassiterite, gold, and wolframite ("conflict minerals") originating in the Democratic Republic of Congo. The regulation requires disclosure by any reporting companies under the 1934 Act for which a conflict mineral is "necessary to the functionality or production of a product manufactured by that company."

Within 270 days of the passing of the Act, the SEC will be required to promulgate rules requiring regulated companies to report annually if any of the conflict minerals used in their products originated in the Democratic Republic of Congo or an adjoining country. Such companies must also disclose measures, such as due diligence and chain-of-custody reports, to ensure that their actives involving the conflict minerals did not directly or indirectly finance or benefit armed groups in the Democratic Republic of Congo or an adjoining country. The Act also sets out standards for independent third party audits which reporting companies will be required to undertake.

A product that is determined not to contain conflict minerals that directly or indirectly benefit or finance armed groups in the Democratic Republic of Congo or an adjoining country may be labeled "DRC conflict free". These reporting requirements will terminate on the later of certification by the President that no armed groups continue to be directly involved and benefitting from commercial activity involving conflict minerals or the day after the fifth anniversary of the enactment of the Act.

Section 1502 also requires the State Department to submit to appropriate Congressional committees a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, and commercial products within 180 days of enactment of the Act. The State Department will also be required, within the same timeframe, to produce and publish a map of mineral-rich zones, trade routes, and areas under the control of armed groups in the Democratic Republic of the Congo and adjoining countries based on data from multiple sources, including the United Nations, the Congolese government and non-governmental organizations. The State Department will be required to update the map every 180 days, for so long as the conflict mineral reporting requirements referred to above are in effect.

The GAO of the United States will submit periodic reports to Congress assessing the effectiveness of this system.

Reporting Requirements Regarding Coal or other Mine Safety

Section 1503 of the Act requires each 1934 Act reporting company that is an operator, or that has a subsidiary that is an operator, of a coal or other mine to include in its periodic reports specified safety-related information, including the number of violations that have been cited by the Mine Safety and Health Administration ("MSHA"), the number of violations that could constitute a health hazard, the total value of assessments proposed by the MSHA and the total number of mining-related fatalities.

The section also requires such mine operating companies to report imminent danger orders and certain other findings of the MSHA on Form 8 K.

Disclosure of Payments by Resource Extraction Issuers

Section 1504 of the Act requires the SEC within 270 days of enactment of the Act to promulgate rules requiring each resource extraction issuer to include in its annual report information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals and the type and total amount of such payments made to each government.

Study by the GAO

Section 1505 of the Act requires the GAO to assess the relative independence, effectiveness, and expertise of presidentially appointed inspectors general and inspectors general of designated federal entities and the effects on independence of the amendments to the Inspector General Act of 1978 made by the Act, and to report the results of the assessment to Congress not later than one year after the date of enactment of the Act.

Study on Core Deposits and Brokered Deposits

Section 1506 of the Act requires the FDIC to conduct a study to evaluate (1) the definition of core deposits for the purpose of calculating the insurance premiums of banks; (2) the potential impact on the Deposit Insurance Fund of revising the definitions of brokered deposits and core deposits to better distinguish between them; (3) an assessment of the differences between core deposits and brokered deposits and their role in the economy and banking sector of the United States; (4) the potential stimulative effect on local economies of redefining core deposits; and (5) the competitive parity between large institutions and community banks that could result from redefining core deposits. The FDIC will be required to report the results of the study to Congress not later than one year after the date of enactment of the Act, with legislative recommendations, if any, to address concerns arising in connection with the definitions of core deposits and brokered deposits.

Title XVI.
Section 1256 Contracts

Section 1601 of the Act defines a "section 1256 contract" under the Internal Revenue Code to exclude (i) any securities futures contract or option on such a contract unless such contract or option is a dealer securities futures contract, or (ii) any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement.

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